IN THE COURT OF QUEEN'S BENCH OF
ALBERTA

JUDICIAL DISTRICT OF EDMONTON

ACTION NUMBER 8703-16333

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, CHAPTER C-25, R.S.C. 1970, AS AMENDED

AND IN THE MATTER OF ASSOCIATED INVESTORS OF CANADA LTD.

AND IN THE MATTER OF THE *JUDICATURE ACT*, CHAPTER J-1, R.S.A. 1980, AS AMENDED

AND:

ACTION NUMBER 8703-16334

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, CHAPTER C-25, R.S.C. 1970, AS AMENDED

AND IN THE MATTER OF FIRST INVESTORS CORPORATION LTD.

AND IN THE MATTER OF THE *JUDICATURE ACT*, CHAPTER J-1, R.S.A. 1980, AS AMENDED

FINAL REPORT OF THE INSPECTOR
WILLIAM E. CODE, Q.C.

JULY 18, 1989
CALGARY, ALBERTA

89-05572/

TO: THE HONOURABLE JUSTICE R.L. BERGER

I hereby state my opinion that to the best of my knowledge and belief, the substance of the evidence I have discovered tending to prove those matters enumerated in subsections 223(2)(a) through (d) of the *Business Corporations Act*, S.A. 1981, c. B-15 as amended, and in paragraphs 7.3(b) and (c) of the Orders dated July 29, 1987, as amended and granted by this Honourable Court in these actions, that adversely impacts upon any individual, corporation or regulatory body, has been put to that individual, appropriate officer or officers of the corporation, or representative or representatives of the regulatory agency; either during his or her testimony before me or by compliance with clause 3 of the Order dated November 15, 1988 as modified by the Judgment Roll of the Court of Appeal dated December 7, 1988.

The following is my final report.

All of which is respectfully submitted.

"W. E. Code"

WILLIAM E. CODE, Q.C.
July 18, 1989
Calgary, Alberta

PREFACE AND ACKNOWLEDGMENTS

By court orders dated June 30, 1987 First Investors Corporation Ltd. and Associated Investors of Canada Ltd. — FIC and AIC — were ordered to cease acting as issuers of investment contracts under the *Investment Contracts Act* and were placed under the *Companies' Creditors Arrangement Act*. A series of related orders followed, and on August 13, 1987 I was appointed as the Inspector to conduct an Investigation as enabled by Part 18 of the *Business Corporations Act*.

This is the report of my Investigation. The scope of the Investigation and therefore of this Report are defined by the legislation and the court orders. Their contents and how they have been construed are outlined in Chapter I. The process by which I have proceeded to carry out my mandate is the subject of Chapter II.

The 5 chapters comprising the middle of the Report are taken up with the details of the business and affairs of FIC and AIC, and because of their entanglements with affiliates and parents the subject of this part of the Report, limited to FIC and AIC in some respects in compliance with the court orders, is the Principal Group. Chapter III is an overview of the functioning and control of the Principal Group and of its composition.

The subjects of chapters IV through VII are implicit in their titles: Money-In, Money-Out, Management Response to Economic Problems, and Reasons for the Financial Failure of FIC and AIC.

Chapter VIII focuses specifically on the business and affairs of FIC and AIC. Activities of the balance of the empire are of only incidental concern because FIC and AIC were subject to regulation by the Alberta government under the *Investment Contracts Act* while affiliates were regulated otherwise where at all. The role of the individual elected and non-elected governmental regulators and the statute which they administered are the subject of this, the final chapter of the substantive report.

The back of the Report contains the appendices and schedules. My mandate requires that I report the legal framework that guided my Investigation. There are legal references interspersed throughout the Report, and sketches on fraud in civil and criminal law, directors' duties and oppression, unfair prejudice and unfair disregard of security holders' interests, income tax law, public law duties of governmental actors and related matters make up Appendices 1 through 5.

The schedules include helpful summary lists, e.g. of directors of various companies, and select evidentiary documents, e.g. corporate organization chart and diagrams depicting certain significant and complex transactions.

All parties who appeared before me were most ably represented by counsel. Generally counsel for all parties and counsel to me agreed to the action necessary to complete this investigation with as much dispatch as possible. I sincerely thank all of them for their cooperation and assistance in facilitating the investigation and I congratulate all of them on the capable fashion in which they represented their respective clients.

N.C. Wittmann, Q.C. was my counsel from the first day on this matter. I could not begin to properly praise the magnificent job done by him in coordinating the search for evidence, calling of witnesses, conducting the examinations of witnesses and providing assistance in writing this Report. His task was mammoth, comprising long hours and tedious work, but was always done with a grace and a sense of humour which made this Investigation interesting to the end. J.T. Eamon contributed to the Investigation with diligence, talent and boundless dedication. To both of them I am most grateful. The contributions made by others on my legal staff are known to them personally, and so is my appreciation. L.A. Taylor contributed generously in all respects and deserves special acknowledgement. The same goes for C.M. Skene and M.A. Sigurdson. I also express my thanks to E.P. Groody for his editorial assistance.

I must say in closing that the conduct of this very complex and arduous Investigation was made considerably more pleasant through the participation of so many dedicated and capable individuals in technical and professional capacities. I thank those who played a part in whatever role for the courtesy and cooperation that was typical of all who participated.

GLOSSARY OF TERMS

The following abbreviations are used in this Report:

Full Name	**Abbreviation**
Those persons or bodies responsible for administering the *Investment Contracts Act* from time to time in Alberta	Alberta regulators or regulators
Alberta Stock Exchange	ASE
Treasury Department, Alberta	Alberta Treasury or Treasury
Allarco Group Ltd.	AGL
Allarco Energy Ltd.	Allarco
Associated Investors of Canada Ltd.	AIC
Athabasca Holdings Limited	AHL
Alberta Securities Commission	ASC
Those persons or bodies charged with regulatory authority over FIC and AIC in British Columbia	British Columbia regulators
Business Corporations Act, S.A. 1981, c. B-15, as amended	*BCA*
Canadian and British Insurance Companies Act, R.S.C. 1985, c. I-12, as amended	*CBICA*
Canadian Imperial Bank of Commerce	CIBC
Canadian Institute of Chartered Accountants	CICA
Canada Deposit Insurance Corporation	CDIC
Carma Developers Ltd.	Carma
Collective Mutual Fund Ltd.	CMF
Collective Securities Inc.	CSI
Collective Securities Ltd.	CSL
CPF Advisory Services Ltd.	CPF
Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended	*CCAA*
Cormie Ranch Inc.	CRI
Cormie Ranch Ltd.	CRL
County Investments Ltd.	CIL
Department of Consumer & Corporate Affairs, Alberta	CCA
East West Canadian Investments Inc.	East/West
Estate Loan & Finance Ltd.	EL&F

Full Name	Abbreviation
F & A Development Corporation	F&A
First Investors Corporation Ltd.	FIC
Generally Accepted Accounting Principles	GAAP
General Equities Holdings Ltd.	GE
Generally Accepted Auditing Standards	GAAS
Glen Eden Realty & Development Ltd.	Glen Eden
Investment Contracts Act, R.S.A. 1980, c. I-10, as amended	*ICA*
Investment Funds Institute of Canada	IFIC
Judith Anne Investments Limited	JAIL
Lake Okanagon Resort Ltd.	LOR
Lake Resort Financial Services Ltd.	LRFS
Levesque Beaubien Inc.	Levesque
Marquette Realty & Development Ltd.	Marquette
Matrix Investments Limited	Matrix
Merrill Lynch Canada Inc.	Merrill Lynch
Northwest International Bank & Trust Co.	Bank
North West Trust Company	NWTC
Pinch Penny Investments Ltd.	Pinch Penny
Principal Bond Fund	PBF
Principal Canadian Mutual Fund Ltd.	PCF
Principal Consultants Ltd.	PCL
Principal Equity Fund, Inc.	PEF
Principal Financial Center	PFC
Principal Group or Principal Group of Companies	the Group or Principal
Principal Group Limited	PGL
Principal Growth Fund Ltd.	PGF
Principal Life Insurance Company	PLIC
Principal Multiplier Fund	PMF
Principal Neo-Tech Inc.	PNI
Principal Savings & Trust Company Limited	PS&T
Principal Securities Management Limited	PSML
Principal Speculators Fund	PSF
Principal Venture Fund Ltd.	PVF
Principal World Fund, Inc.	PWF

Full Name	**Abbreviation**
Qualico Developments Ltd.	Qualico
Shucksan Properties Inc.	Shucksan
The task force on financial institutions struck by the Priorities, Finance and Coordination Committee of the Alberta Cabinet in May, 1984	first task force
The task force on trust companies struck by the Priorities, Finance and Coordination Committee of the Alberta Cabinet in April, 1985	second task force
FIC and AIC	the investment contract companies
Rocky Mountain Breweries Ltd.	Rocky Mountain
Rocky Mountain Brewing Corporation	RMBC
Travellers Acceptance Corporation	Travellers
Toronto Stock Exchange	TSE
Touche Ross & Co.	Touche Ross
Westmoreland Capital Ltd.	Westmoreland
Wexford Developments Ltd.	Wexford
Wyocan Resources Ltd.	Wyocan
314986 Alberta Ltd.	314986
318939 Alberta Ltd.	318939
321635 Alberta Ltd.	321635
356538 Alberta Ltd.	356538
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358901 Alberta Ltd.	358901

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I. THE MANDATE

A. INTRODUCTION

My mandate requires that I investigate the following:

(1) FIC and AIC and their affiliates to determine whether I have discovered evidence tending to show that:

  (a) their businesses were conducted or carried on with intent to defraud any person;

  (b) their businesses or affairs were conducted in a manner that was oppressive or unfairly prejudicial to or that disregarded the interests of security holders;

  (c) the powers of their directors were exercised in the manner described in clause (b) above;

  (d) they were formed or dissolved for a fraudulent or unlawful purpose;

  (e) persons concerned with their formation, business or affairs have acted fraudulently or dishonestly;

(2) The reasons for the financial failure of FIC and AIC; and

(3) The sales practices of FIC and AIC and their affiliates.

My mandate is to report to the court whether I have discovered evidence tending to show or prove and tending to disprove the matters I am to determine and investigate. In so doing I am to consider and apply existing law, and to set out my findings of fact in respect to those matters with the evidence in support, naming names. I am to delineate the legal framework that guided my investigation.

It may be helpful to clearly state what my mandate does not permit me to do. I am not to find civil or criminal responsibility, nor do I have any power to do so. In particular, I am not to report my opinion as to whether any individual, corporation or government agency has committed fraud or any other illegal act or is liable for acts of negligence, wrong-doing or illegality.

Some of the words or phrases in the mandate are legal terms of art or are defined by statute. Others are considered in case law or would simply benefit from definition. Accordingly words and phrases important to how I have construed my mandate are expanded upon below, under the heading "Interpretation of the Mandate". Before that, I have set out the relevant excerpts from the orders of the court establishing and amending the mandate, and indicated how I have understood these orders. (A summary of all court orders affecting the Investigation is in Schedule A to this Report.)

B. ESTABLISHMENT AND AMENDMENT

By separate orders of the Court of Queen's Bench of Alberta dated June 30, 1987 in actions numbered 8703-16333 and 8703-16334, First Investors Corporation Ltd. ("FIC") and Associated Investors of Canada Ltd. ("AIC"), defined by the respective orders as the "Debtor Company", were ordered to cease acting as issuers within the meaning of the *Investment Contracts Act*, R.S.A. 1980, c. I-10 ("*ICA*") and were placed under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. 36 ("*CCAA*").

On July 15, 1987 an application was made to the court by Donald Bruce Logan, Suzanne Mah and Peter Inciura for orders pursuant to Part 18 of the *Alberta Business Corporations Act*, S.A. 1981, c. B-15, as amended ("*BCA*"). Orders were granted directing that the orders of June 30, 1987 be amended as follows:

> 7.1 Coopers & Lybrand Limited, the Manager, be appointed as Inspector pursuant to Part 18 of the *Business Corporations Act* (Alberta) to conduct an investigation of the Debtor Company and any of its affiliated corporations (as such term is defined in Section 222 of the *Business*

Corporations Act (Alberta)) to determine whether the business or affairs of the Debtor Company have been carried on or conducted, or the powers of the directors of the Debtor Company have been exercised, in a manner that was oppressive or unfairly prejudicial to or that unfairly disregarded the interests of the security holders of the Debtor Company and report to the Court as required.

The court granted further orders on July 29, 1987, amending the orders of June 30 and July 15, 1987, and directing that:

> 7.1 An inspector (the "Inspector") shall be appointed by this Honourable Court pursuant to Part 18 of the *Business Corporations Act* (Alberta) to conduct an investigation of the Debtor Company and any of its affiliated corporations (as such term is defined in the *Business Corporations Act*) to determine whether:
>
> (a) the business of the Debtor Company or any of its affiliates is or has been carried on with intent to defraud any person;
>
> (b) the business or affairs of the Debtor Company or any of its affiliates are or have been carried on or conducted, or the powers of the directors are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of a security holder;
>
> (c) the Debtor Company or any of its affiliates was formed for a fraudulent or unlawful purpose or is to be dissolved for a fraudulent or unlawful purpose; or
>
> (d) persons concerned with the formation, business or affairs of the Debtor Company or any of its affiliates have in connection therewith acted fraudulently or dishonestly
>
> and report to the Court as required.

• • • • •

> 7.3 With respect to the investigation to be conducted by the Inspector, the following terms will apply:
>
> (b) The Inspector's duties shall include an investigation of the reasons for the financial failure of the Debtor Company as well as any and all transactions which the Inspector deems material entered into between the Debtor Company and its affiliates from and including June 30, 1984;
>
> (c) The Inspector's duties shall include an investigation with respect to the sales practices of the Debtor Company and its affiliates.

By order dated August 13, 1987 I was appointed as the Inspector to conduct the Investigation provided for in the orders of June 30, 1987, as amended.

By order dated March 18, 1988 paragraph 7.3(b) of the orders of July 29, 1987 was amended to provide that:

> (b) The Inspector's duties shall include an investigation of the reasons for the financial failure of the Debtor Company as well as any and all transactions which the Inspector deems material entered into between the Debtor Company and its affiliates from and including June 30, 1984; provided that the Inspector may review those transactions involving the intercorporate movement of funds including those pertaining to County Investments Ltd. and Estate Loan & Finance Ltd., notwithstanding that they may have taken place prior to June 30, 1984.

A second order dated March 18, 1988 further clarified the terms of my mandate. It directed that:

> (a) The Inspector shall not report his opinion as to whether any individual, corporation or government agency has committed fraud or any other illegal act or is liable for acts of negligence, wrongdoing or illegality; and,

> (b) The Inspector shall report to this Court whether he has discovered evidence tending to show those matters enumerated in subsections 223(2)(a) through (d) of the *Business Corporations Act*, S.A. 1981, c. B-15, as amended, and in paragraphs 7.3(b) and (c) of the Orders dated July 29, 1987, as amended, and granted by this Honourable Court in these actions, and in so doing shall:
>
> i) consider and apply existing law;
>
> ii) set out his findings of fact in respect of the said enumerated matters, together with the evidence in support of those findings, and in connection therewith, shall identify in his report those persons whose conduct relates, in whole or in part, to the findings of fact and the evidence in support; and
>
> iii) delineate and report to this Court the legal framework that guided his investigation.

The latter order was appealed by Donald Cormie to the Court of Appeal of Alberta. The first ground of appeal was that Mr. Justice Berger erred in requiring me to report whether I discovered evidence "tending to show" the matters enumerated in ss. 223(2)(a) through (d) of the *BCA* and set forth in the July 29, 1987 orders, and in doing so to "name names".

Mr. Justice Foisy commented on this ground in delivering the judgment of the Court of Appeal on June 3, 1988 at 10:

> With respect to the first ground of appeal, it is submitted that the learned chambers Judge confounded the process of (a) identifying evidence relevant to each issue, and (b) drawing conclusions that the evidence proves or tends to prove the issue. In my view, the two go hand-in-hand. It is difficult to understand how the Inspector could identify evidence relevant to each issue, that is to each of the terms of reference contained in the July 29, 1987 Order, without concluding that that evidence proves or tends to prove that particular issue or issues. That process does not mean that the Inspector is adjudicating or determining civil or criminal responsibility. As the learned chambers Judge quite properly pointed out, that is not the function of the Inspector. While the Inspector must refrain from giving opinions that determine criminal or civil responsibility, nonetheless he must be able to report to the Court in a comprehensive fashion, facts found by him. To do so, he must be able to clearly set out his understanding of the law that applies to the issues before him, decide issues of credibility, and set out his findings of fact because they show, tend to show, or relate to matters described in the terms of reference.

The corresponding order of the Court of Appeal directed that:

> 1. In addition to the directions contained in paragraph 1(b) of the Order under appeal, the Inspector is directed that, in reporting whether he has discovered evidence tending to show those matters enumerated in subsections 223(2)(a) through (d) of the *Business Corporations Act*, S.A. 1981, c. B-15, as amended, and in paragraphs 7.3(b) and (c) of the Orders dated July 29, 1987, as amended, and granted by the Court of Queen's Bench in these actions, he shall report whether he has discovered evidence both tending to prove and tending to disprove the said enumerated matters.

Donald Cormie sought leave to appeal from the Court of Appeal decision to the Supreme Court of Canada. His application for leave to appeal was heard on January 23, 1989 and dismissed on February 2, 1989.

It was submitted by some counsel that subparagraphs 7.3(b) and (c) of the orders of July 29, 1987 do not purport to extend the terms of my mandate beyond that set forth in s. 223(2) of the *BCA*; rather, that my attention is thereby directed to specific factual areas which I am to investigate in my quest for evidence tending to show those matters enumerated in subparagraph 7.1 of the orders.

I consider this submission to be in error, based on the orders of the court. The Queen's Bench order of March 18, 1988, set out above, clearly refers to:

> . . . those matters enumerated in subsections 223(2)(a) through (d) of the [*BCA*] . . . *and* in paragraphs 7.3(b) and (c) of the orders dated July 29, 1987, as amended . . . [emphasis added].

In his reasons for judgment giving rise to the foregoing order, Mr. Justice Berger stated at 21:

> It is urged upon me that the phrase "to determine", in s. 223(2) of the Act, confers upon the Inspector the jurisdiction to report his opinion as to whether the enumerated subject matters set out at s. 223(2)(a) through (d) have been made out. I do not agree. In my view, the phrase "to determine" (which is employed in relation to the criteria for the appointment of an Inspector) is intended only to focus upon and delineate those matters which are to be investigated.

His lordship went on to state at 23:

> "Investigation" has been defined as: "the action of investigating; the making of a search or inquiry; systematic examination, careful or minute search" (Oxford English Dictionary). A search or inquiry must be made with some object in mind. A systematic inquiry requires a guiding paradigm. *The objects which guide the Inspector's investigation are set out in paragraphs 7.1 and 7.3 of the Order of July 29, 1987.* [Emphasis added.]

Mr. Justice Berger stated at 26 that:

> . . . As a necessary corollary of his fact-finding role, [the Inspector] shall consider and apply existing law in reporting to the Court whether he has discovered evidence "tending to show" those matters enumerated in ss. 223(2)(a) through (d); he will set out his findings of fact together with the evidence in support of those findings; he will delineate the legal framework that guided his investigation. *The Inspector will report in a similar manner with respect to those matters referred to in paragraphs 7.3(b) and (c) of the Order* and with respect to those subjects set out in his Interim Report to the Court [emphasis added].

Mr. Justice Berger by order dated November 15, 1988, as corrected, directed that:

> 2. The Inspector [be] at liberty to adopt the following procedures in preparation of his report to the Court:
>
>   (b) draft his own conclusions whether the evidence tends to show those matters enumerated *in subsections 223(2)(a) through (d)* of the *Business Corporations Act* S.A. 1981, c. B-15, *and in paragraphs 7.3(b) and (c) of the Orders dated July 29, 1987, all as amended*; [emphasis added].

It was further directed by order dated February 14, 1989 that:

> 3. The Inspector may entertain submissions of counsel respecting whether there is evidence tending to show those matters enumerated *in subsections 223(2)(a) through (d)* of the Business Corporations Act S.A. 1981, c. B-15, as amended, *and in paragraphs 7.3(b) and (c) of the Orders dated July 29, 1987, as amended*, and granted by this Honourable Court in these actions. For greater certainty, the Inspector is at liberty to consider both civil and criminal law in carrying out his mandate established by previous orders of this Court and in particular the Orders dated March 18, 1988, but he shall not pronounce on civil or criminal liability; accordingly, subject to paragraph 2 of this Order, counsel may make submissions in relation to the consideration and application of existing law, both civil and criminal, to the legal framework, both civil and criminal which, in the submission of counsel, ought to guide the Inspector in his duties [emphasis added].

Section 224(1) of the *BCA* provides that the court may make any order it thinks fit concerning the Investigation. It is apparent from the aforementioned orders, and the reasons for them, that I have been directed to investigate and report my conclusions with respect to whether I have discovered evidence tending to show both those matters enumerated in ss. 223(2)(a) through (d) of the *BCA*, as reflected in paragraphs 7.1 of the orders of July 29, 1987, and those matters outlined in paragraphs

7.3(b) and (c) of those orders. Had the court not intended paragraphs 7.3(b) and (c) to stand independently of those matters enumerated in paragraph 7.1, there was no need for their inclusion. I therefore conclude that the court directed that I also conduct an investigation and report on the reasons for the financial failure of FIC and AIC and the sales practices of FIC and AIC and their affiliates.

C. INTERPRETATION OF THE MANDATE

The applicable provisions of the *BCA* and of the various orders include a number of words and phrases which must be defined in order to understand how I have construed the nature and extent of my mandate.

(a) "*debtor company*"

"Debtor company" is defined by the various orders to mean FIC and AIC.

(b) "*affiliates*"

The word "affiliates" appears in ss. 223(2)(a), (b), (c) and (d) of the *BCA* and in the orders of July 29, 1987.

The *BCA* provides in s. 1(a.1) that "'affiliate' means an affiliated body corporate within the meaning of section 2(1)"; the latter provides as follows:

> 2(1) For the purposes of this Act,
>
> (a) one body corporate is affiliated with another body corporate if one of them is the subsidiary of the other or both are subsidiaries of the same body corporate or each of them is controlled by the same person, and
>
> (b) if 2 bodies corporate are affiliated with the same body corporate at the same time, they are deemed to be affiliated with each other.

"Subsidiary" is then defined in s. 2(4) as follows:

> 2(4) For the purposes of this Act, a body corporate is a subsidiary of another body corporate if
>
> (a) it is controlled by
>
> (i) that other,
>
> (ii) that other and one or more bodies corporate, each of which is controlled by that other, or
>
> (iii) 2 or more bodies corporate, each of which is controlled by that other,
>
> or
>
> (b) it is a subsidiary of a body corporate that is that other's subsidiary.

Section 2(2) of the *BCA* sets out when a body corporate is "controlled":

> (2) For the purposes of this Act, a body corporate is controlled by a person if
>
> (a) securities of the body corporate to which are attached more than 50% of the votes that may be cast to elect directors of the body corporate are held, other than by way of security only, by or for the benefit of that person, and
>
> (b) the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the body corporate.

The *BCA* provides in s. 1(e) that a "body corporate" includes "a company or other body corporate wherever or however incorporated". A "body corporate" is distinguished under the *BCA* from a "corporation". The latter is defined by s. 1(f.1) as "a body corporate incorporated or continued under this Act and not discontinued under this Act".

(c) "*intent to defraud*"

The phrase "intent to defraud" is found in both s. 223(2)(a) of the *BCA* and in paragraph 7.1 of the orders as amended on July 29, 1987.

For an outline of the subjective mental element in the law of criminal fraud see Appendix 1 under the heading "*Mens Rea*". The intentional element in the civil law of fraud is concisely stated in Spencer Bower and Turner, *The Law of Actionable Misrepresentation* (1974, 3rd ed.) at 118 as follows:

> . . . Here it is sufficient to observe that although fraud necessarily involves an intention on the part of the representor that the representee shall act in the way in which he does eventually act, yet there is no necessity to prove any intention further or more remote than this — and certainly the *motive* of the representor is quite irrelevant. It is immaterial that the plaintiff may or may not be able to show, for instance, that the representation was made with the intention or motive of damaging the representee, or of benefitting himself, or a third person; or even that it is shown that his intention or motive was possibly even to benefit the representee, but that the scheme went awry. A false representation made without honest belief in its truth will be fraudulent if made with intention that the representee act upon it, even if it be made without any demonstrable motive or intention whatever.

(d) "*business or affairs*"

The phrase "business or affairs" appears in ss. 223(2)(b) and (d) of the *BCA* and in paragraph 7.1 of the order as amended on July 29, 1987.

"Affairs" is defined by the *BCA* in s. 1(a) as the "relationships among a corporation, its affiliates and the shareholders, directors and officers of those bodies corporate but does not include the business carried on by those bodies corporate". "Business" is not defined by the *BCA*.

There are numerous cases considering the meaning of the word "business" as it appears in various enactments. According to Willes, J.: "'Business' has a more extensive meaning than the word 'trade'": *Harris* v. *Amery* (1875-76), L.R. 1 C.P. 148. On the other hand, it has been said that: "Ordinarily speaking, business is synonymous with 'trade'": *Delany* v. *Delany*, 15 L.R.Ir. 67, per Chatterton, V.C.

In *Smith* v. *Anderson* (1880), 15 Ch. D. 247 (C.A.) at 258 Jessel, M.R. stated that "anything which occupies the time and attention and labour of a man for the purpose of profit is business." "Business" has been judicially defined as including "employment that occupies the time, attention, and labour": *Shaw* v. *McNay*, [1939] O.R. 368 (H.C.); and may also include any activity without contemplation of pecuniary profit: *Samson* v. *M.N.R.*, [1943] 2 D.L.R. 349 (Exch.); *Doggett* v. *Burnet*, 62 App. D.C. 103, 65 F. 2d 191 (1933) at 193.

A question before the court in *Re Pszon*, [1946] 2 D.L.R. 507 (Ont. C.A.) was whether a person carried on business on his own account pursuant to the *Bankruptcy Act*, R.S.C. 1927, c. 11. Laidlaw, J.A. reasoned as follows at 511:

> The word "business" is of wider import than "trade" *Re a Debtor*, [1927] 1 Ch. 97 at p. 105. As used in various statutes it involves at least three elements: (1) the occupation of time, attention and labor; (2) the incurring of liabilities to other persons; and (3) the purpose of livelihood or profit.

Given that "affairs" encompasses only the internal activities of the companies, the necessary and reasonable implication is that "business" encompasses the external activities carried on by the companies and, in particular, the time, attention and labour expended by them in the pursuit of their corporate objectives.

(e) *"powers of the directors"*

The mandate directs me to investigate and determine whether "the powers of the directors" of FIC and AIC have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of a security holder. In this regard see Appendix 3.

"Director" is defined by the *BCA* in s. 1(h.1) to mean:

> A person occupying the position of director by whatever name called and "directors" and "Board of Directors" includes a single director.
>
> The *BCA*, s. 97(1) provides that:
>
> Subject to any unanimous shareholders agreement, the directors shall manage the business and affairs of a corporation.

Pursuant to s. 110(1) "any of the powers of the directors" may be delegated to a managing director or a committee of directors, subject to limits on the delegation of powers by directors set out in s. 110(3).

That section and other provisions of the *BCA* and the relevant company law are considered in Appendix 3.

Shareholders of a corporation may by a unanimous shareholder agreement (defined in the *BCA*, s. 1(z)) provide for "the management of the business and affairs of the corporation, including the restriction or abrogation, in whole or in part, of the powers of the directors": *BCA*, s. 140(1)(c). Shareholders exercise their control generally through their power to elect directors: *BCA*, ss. 101(3), 140(1)(b).

Parsons v. *Minister of National Revenue*, [1984] 1 F.C. 804 (T.D.), reversed on other grounds [1984] 2 F.C. 331 (C.A.) described the role of a director at 825 as follows:

> Basically, the directors of a company are those persons acting collectively to whom the duty of managing the general affairs of the company is delegated by the shareholders. Their duty is to conduct the business of the company for the greatest benefit of the shareholders.
>
> Directors have been described as "agents", "trustees" and "managing partners", but each such description has been judicially negated.
>
> They have been held not to be exactly agents, not exactly trustees, not exactly managing partners. They are not the masters of the shareholders; neither are they servants of the shareholders. Their relationship is one requiring an exercise of fidelity having in view the purposes for which they are appointed and the statutory provisions under which their appointment is made.

The phrase "powers of the directors" encompasses a wide range of obligations and responsibilities. As such powers may be delegated by the directors or withheld from the directors by virtue of a unanimous shareholder agreement, I interpret this phrase in my mandate to encompass an investigation into the exercise of the aforesaid powers, in light of the legal meaning of the qualifying words, regardless of whether they were exercised by the directors themselves or by shareholders, or whether they were delegated by whatever means to officers, or exercised by individuals who usurped the directors' powers.

(f) *"oppressive or unfairly prejudicial to or . . . unfairly disregards the interests of a security holder"*

This phrase appears in s. 223(2)(b) of the *BCA* and in the orders of July 15, 1987 and July 29, 1987.

The terms "security" and "debt obligation" are defined in the *BCA*, ss. 1(u) and (g.1) as follows:

> 1(u) "security", except in Part 6, means a share of any class or series of shares or a debt obligation of a corporation and includes a certificate evidencing such a share or debt obligation.
>
> * * *
>
> (g.1.) "debt obligation" means a bond, debenture, note or other evidence of indebtedness or guarantee of a corporation, whether secured or unsecured.

The *BCA* defines "security" as including a debt obligation of a corporation, and defines "debt obligation" as a bond, debenture, note or other evidence of indebtedness or guarantee of a corporation, whether secured or unsecured. As an "investment contract" within the meaning of the *ICA* (quoted in chapter III below) is defined as a "contract, agreement, certificate, instrument or writing containing an undertaking by an issuer to pay the holder thereof", an investment contract is a debt obligation within the meaning of the *BCA* and as such falls within the definition of "security" in the *BCA*.

Section 41(1) of the *ICA* provides that Part 17 of the *BCA* does not apply to an issuer under the *ICA*. Part 17 is entitled "Liquidation and Dissolution". This Investigation is pursuant to Part 18 entitled "Investigation". Thus, I conclude that an investment contract holder is a security holder in regard to whom it may be said that the business or affairs of the corporation have been carried on in a manner which was oppressive or unfairly prejudicial or whose interests were unfairly disregarded.

For an outline of the legal meaning of the phrase "oppressive or unfairly prejudicial to or . . . unfairly disregards the interests of . . ." see Appendix 3.

(g) "*fraudulent or unlawful purpose*"

"Fraudulent" and "defraud" are used in the *BCA*, ss. 223(2)(a), (c) and (d), and in the orders of July 29, 1987. The phrase "unlawful purpose" is used in s. 223(2)(c) and the July 29, 1987 orders.

For an outline of the civil and criminal law of fraud refer to Appendix 1. For a consideration of the legal framework governing fraud affecting public markets and market manipulation see Appendix 2.

The word "unlawful" *prima facie* means contrary to law or an act which the law prohibits: *Roe* v. *Township of Wellesley* (1918), 43 O.L.R. 214 (H.C.).

In considering the meaning of "unlawful" the court held that the term should be taken to include not only what is contrary to law, but also the violation of some legal right, or the doing of something illegal, such as making a contract expressly aimed at restraint of trade; the word means "not authorized by law": *Rex* v. *Robinson* (1948), 92 C.C.C. 223 (Ont. C.A.).

The term "purpose" was judicially defined in *Bannerman* v. *Minister of National Revenue*, [1957] Ex. C.R. 367 at 373, affirmed [1959] S.C.R. 562, as follows:

> In the absence of any definition of the word "purpose" . . . I think, to conform to its meaning, there should exist at least a reasonably direct relationship between the objective sought, the means employed to obtain it, and the expenditure made thereon.

R. v. *Brown* (1982), 20 Alta. L.R. (2d) 304 (C.A.) at 349, quoting from *The Shorter Oxford English Dictionary* and *Black's Law Dictionary* (4th ed.), defined "purpose" as "the action or fact of intending or meaning to do something". Another definition accepted was: "that which one sets before him to accomplish; an end, intention, or aim, object, plan, project."

"Unlawful purpose" as that phrase was used in s. 423(2)(a) of the *Criminal Code*, R.S.C. 1970, means contrary to law; that is, prohibited by federal or provincial legislation: *Gralewicz et al.* v. *The Queen*, [1980] 2 S.C.R. 493. The court cited Kenny's *Outlines of Criminal Law* (1966, 19th ed.)

and stated at 509 that "unlawful purposes" within the context of the English common law relating to criminal conspiracy included:

> 1. Agreements to commit a substantive crime;
> 2. Agreements to commit any tort that is malicious or fraudulent;
> 3. Agreements to commit a breach of contract under circumstances that are peculiarly injurious to the public; and
> 4. Agreements to do certain other acts which (unlike all those hitherto mentioned) are not breaches of law at all, but which nevertheless are outrageously immoral or else are, in some way extremely injurious to the public.

International Brotherhood of Teamsters v. *Therien*, [1960] S.C.R. 265 at 280 and *Gagnon* v. *Foundation Maritime Limited*, [1961] S.C.R. 435 at 446 held that "unlawful purposes", as that phrase relates to the tort of conspiracy, include tortious acts and acts which are contrary to both statute and common law. The words "unlawful purpose" used in the context of a labour relations dispute were interpreted in *Pacific Western Airlines Limited* v. *International Union et al.* (1986), 70 A.R. 67 (C.A.) as including certain acts of a union which were contrary to common law rules respecting picketing.

Zimmermann v. *Letkeman*, [1978] 1 S.C.R. 1097 at 1101 adopted and approved of the following passage from *Alexander* v. *Rayson*, [1936] 1 K.B. 169 (C.A.) per Romer, L.J. at 182:

> It is settled law that an agreement to do an act that is illegal or immoral or contrary to public policy, or to do any act for consideration that is illegal, immoral or contrary to public policy, is unlawful and therefore void. But it often happens that an agreement which in itself is not unlawful is made with the intention of one or both parties to make use of the subject matter for an unlawful purpose, that is to say a purpose that is illegal, immoral or contrary to public policy.

For the purposes of my mandate, I have interpreted the phrase "unlawful purpose" in accordance with the quoted passage from *Zimmermann*.

(h) "*persons concerned*"

This phrase appears in s. 223(2)(d) of the *BCA* and in the orders of July 29, 1987.

The *BCA*, s. 1(n) defines "person" as including "an individual, partnership, association, body corporate, trustee, executor, administrator, or legal representative". In s. 1(j.1) "individual" is defined as a "natural person".

"Concerned" was interpreted in *McCausland* v. *Hill* (1896), 23 O.A.R. 738 (C.A.) as meaning "having something to do with".

The phrase "concerned in" has been frequently judicially considered in the context of non-competition agreements. In *Hill (George) & Co.* v. *Hill* (1886), 55 L.T. 769 (Ch. D.) the plaintiffs sued on a covenant enjoining the defendant from being "[engaged] in, or [being] in any way concerned or interested in any similar business. . .". Kekewich, J. stated at 771:

> It is not necessary to say whether he is "engaged or interested in" the business, "interested" meaning, in commercial language, "entitled to profits", but . . . the words "concerned in" were intended to cover this exact case, and I must regard them as meaning "having something to do with" a similar business.

Similarly, in *Batts Combe Quarry Ltd.* v. *Ford*, [1943] Ch. 51 (C.A.) Lord Greene, M.R. considered the case of a person agreeing not to be "concerned in the business of a quarry". He held at 53 that:

> The word "concerned" is of quite general import. Clearly it cannot be limited to "concerned" in the sense of financial interest or of being an employee of the business. Again, I can see no more effective way of being concerned in a business than by providing the capital necessary to establish it.

Lord Halsbury, L.C. stated in *William Cory & Son Ltd.* v. *Harrison*, [1906] A.C. 274 (H.L.) at 275 that:

> It would be absolutely impossible . . . to lay down with precision what is or is not comprehended in such words as "interested or concerned in". You must look at the facts of the particular case and look at the business meaning of the words. That is the question to be determined. What was the business meaning of these words . . .?
>
> When you are dealing with the carrying on of a business and endeavouring to prevent the carrying on of that business directly or indirectly, or the having any part or concern in that business, I think every business man would quite comprehend that the mere fact of being a creditor of the firm is not being "concerned or interested in" it.

The *ICA* provides a framework for regulatory control of the issuance and sale of investment contracts. The provisions of the *ICA* and other aspects of governmental regulation are examined in Chapter VIII of this Report. The *ICA* provides for registration of companies who offer for sale, sell, make or enter into investment contracts of their own issue and for the registration of persons employed, appointed or authorized by investment contract companies to sell investment contracts. The *ICA* also provides for the filing and approval of investment contract forms and documents used by companies or salesmen in connection with the sale of any investment contract. The *ICA* also provides for, *inter alia*: filing financial statements; methods used in valuing assets; required reserves, assets on deposit, and other financial matters; permissible investments and uses of funds; and reviewing the operations of investment contract companies. In brief, many significant aspects of the operation of an investment contract company are regulated.

In construing a statutory provision providing for what interests members of a local council may have in contracts made with the council McCardie, J. in *Everett* v. *Griffiths*, [1924] 1 K.B. 941 (K.B.) stated at 946 that:

> . . . a person may be "concerned in" a contract even though he does not participate in the profits.

At 947 he stated:

> A man is of course "concerned" in a contract if he is in any way a party to it, whether as a sole contractor or as a partner or as an undisclosed principal. A concealed interest is as much an interest as an open interest. The Court will always look at the substance and not at the colourable externals. . . .

Thompson Brothers & Co. v. *Amis*, [1917] 2 Ch. 211 (Ch. D.) interpreted a section of *The Finance Act*, 1916 (repealed) which contained provisions as to excess profits duty in reference to directors' fees. "Directors" was defined as including any managers or "persons concerned in the management of the trade or business", who were remunerated out of the trade or business. Sargant, J. stated at 224 that:

> That phrase "person concerned in the management of the trade or business" is obviously intended by the Legislature to be a phrase of wider denotation than, and including more persons than are included in, the term "manager".

I have interpreted the word "concerned" in accordance with the foregoing authorities and, in particular, I have concluded that a pecuniary interest is not essential. As noted, Government regulators exercised their authority over many aspects of the business of FIC and AIC; therefore, and as a pecuniary interest is not required, I have considered Government regulators as being persons concerned.

(i) *"fraudulently or dishonestly"*

This phrase appears in the *BCA*, s. 223(2)(d) and in the orders of July 29, 1987. The phrase must be read in the context of the statute and the separate words in the context of their position one to the other, joined by the word "or".

On the face of it "dishonestly" means something different from "fraudulently", the "or" being disjunctive. Although there are some United States authorities which stand for the proposition that these two words can sometimes be used as synonyms, I interpret the phrase as used in my mandate such that dishonest conduct may mean something different from fraudulent conduct.

I am of the view, following the authorities outlined in Appendix 1, that the elements of dishonesty are an intention, imputed or otherwise, to conceal, cheat or deceive. As stated in Appendix 1, dishonesty is a necessary element of civil or criminal fraud. In the context of the *BCA*, I am of the view that my mandate includes direction to report whether or not I have discovered evidence tending to show dishonesty or tending to show whether a person has acted dishonestly when that conduct may or may not amount to fraudulent conduct. The elements of civil and criminal fraud include deprivation or damage, in addition to the element of dishonesty.

In short, in the context of my mandate, all fraudulent conduct includes dishonest conduct but not all dishonest conduct amounts to fraudulent conduct.

(j) *"reasons for the financial failure"*

I am directed to investigate and report on the "reasons for the financial failure". It therefore is necessary to define what is meant by the term "reasons".

The ordinary meaning of "reason" in this sense is the basis or explanation or grounds for something.

In *Bryant* v. *State Personnel Board*, 215 P.2d 512 (1950), the California District Court of Appeal considered the requirement that the state personnel board provide specific reasons when giving a notice of rejection to a probationary employee. The reasons stated by the Board were that the employee's rejection was for the good of the service, that his conduct and actions were unbecoming an employee and that he failed to demonstrate merit and fitness. In rejecting these statements as being mere conclusions and not the reasons underlying such conclusions, it was held that while the statements may be the causes, they were not the reasons for rejection. The court stated at 513:

> The gist of said code section appears to be the specific reasons existing which would "give effect to the rejection". "Reason" is variously defined as:
>
>> "That which is supposed or affirmed to support or justify any conclusion, belief, or plan of action; a fact, truth, or end to be attained, which drives the mind as a rational ground or motive; proof for an opinion, judgment or resolution, principle of thought or action." (Funk and Wagnall's New Standard Dictionary)
>>
>> "Any expression or statement offered as an explanation of a belief or assertion or as a justification of an act or procedure; any sufficient ground of explanation or of logical defense." (Webster's New International Dictionary)
>
> Thus it is apparent from a reading of the code section that justification for the rejection of a probationary employee, lies not in the appointing power's conclusion, as in the present case, that the action is for "the good of the service and failure to demonstrate merit and fitness" or that "the conduct and actions" were unbecoming to such an employee. Rather the justification therefor lies in the factual reasons which support or justify such conclusion by said appointing power that the rejection of the employee would be for the good of the service. In other words, while the notice of rejection undoubtedly stated a good cause for removal such a statement is not an adequate "statement of the specific reasons therefor" as contained in said section.

In *City of Dayton* v. *Borchers*, 232 N.E.2d 437 (1967), the Ohio Court of Common Pleas examined the meaning of the word "reason" in an eminent domain proceeding in which the landowners questioned the right of and necessity for appropriation of all of their land. The court stated at 441 that:

> Reason has been defined as a motive or cause for an action. Plaintiff's reason for appropriating the land of the defendants has been explained and justified by the facts, circumstances, inducement, and the like, together with the workings of the mind upon them. Its reasons have included purpose and motive as internal and subjective elements, and also grounds and arguments that are external and objective. The purpose of an action is the effect that it is intended to produce; its motive is the inner impulse that sets it in motion and guides it. Grounds are the facts, data, etc., that the mind weighs in reaching a decision; and argument is the logical demonstration of how these facts and data determine the decision. The evidence is indicative that the plaintiff's action was accountable with the aforesaid processes.

In *McKenna* v. *White*, 192 N.E. 84 (1934), the Supreme Judicial Court of Massachusetts examined the meaning to be given to the word "reasons" as it was used in a statute requiring that "removals from appointive offices . . . be accompanied by a statement of the reason or reasons therefor . . .". The court stated at 85:

> . . . Cause occasions the removal. It is a succinct statement of that which produces or leads to removal as the result. Reason or reasons are the circumstances, the proofs, the facts or the motives, which generate the conviction that there ought to be removal. A statement of the reason or reasons for removal is a full and fair answer to the question why was the removal made. The statement of a cause may be in general terms. A statement of the reason or reasons must be somewhat definite and detailed. *Underwood* v. *Board of County School Commissioners*, 103 Md. 181, 63 A. 221. The good of the service is a sufficient statement of a cause for removal. It is not an adequate statement of the grounds which create the state of mind precedent to the establishment of that cause in the opinion of the removing person or board. A statement of the reason or reasons leading to the removal of another from office explores the mind and searches the conscience more deeply than the statement of the cause.

Following the ordinary meaning of the word and the judicial definitions found in the case law, I interpret my mandate as requiring that I investigate and report on the facts and circumstances surrounding the financial failure of FIC and AIC and that I provide an explanation or answer to the questions of "how" and "why" the companies failed.

In doing so, I will consider the causes of the financial failure of FIC and AIC.

Had my mandate directed me to report on the causes of the financial failure of FIC and AIC, I would need only report the evidence I had discovered which tended to show, as a cause and effect relationship, that which produced or gave rise to their failure. While a statement of the causes of the financial failure may be relatively brief, a statement of the reasons for the financial failure must of necessity include an explanation.

Any statement as to the reasons for the financial failure of FIC and AIC necessarily involves a review of the companies' entire operations, including their investment strategies. These companies were regulated by statute and therefore the facts and circumstances surrounding their financial failure also necessitates a review of the regulatory environment in which they operated. In particular, the circumstances surrounding the companies' compliance with the statute and the conduct of the public authorities who were charged with administering and ensuring the companies' compliance with the statute must be reviewed.

While these latter facts and circumstances may not have been the cause of the financial failure, they are nonetheless an integral part of any discussion of the reasons for the financial failure of FIC and AIC insofar as they are necessary to answer or explain how and why these companies failed.

D. LEGAL FRAMEWORK

(a) *Legal Framework Guiding the Investigation*

Pursuant to the second order of March 18, 1988, I have delineated the legal framework that guided my investigation, and it is set out in the body of my Report and in the Appendices.

(b) *Standard of Proof*

The phrase "evidence tending to show" appears in the order granted by Mr. Justice Berger on March 18, 1988 and in the order of the Court of Appeal dated June 3, 1988.

Mr. Justice Foisy in delivering reasons for the Court of Appeal on June 3, 1988, stated at 12:

> Special Counsel, Mr. White, submits that the words "tend to show" really mean "tend to prove" and in the end result mean "relevant to". I agree. I would add that relevant evidence may not only tend to prove something but may also tend to disprove something. It is in that sense that the words "tend to show" used by the learned chambers judge should be interpreted and it is with that meaning in mind that the inspector should report to the Court. Indeed Mr. Kenny, counsel for the appellant, conceded that he would be agreeable to that interpretation of the phrase in question.

It has been submitted by various counsel that in determining whether to report on evidence affecting an individual person, I should refrain from reporting that I have "discovered evidence tending to prove or disprove" one of the enumerated matters in my mandate, unless I am satisfied beyond a reasonable doubt as to the existence of the facts alleged to "tend to show" dishonesty or fraud.

Hanes v. *Wawanesa Mutual Insurance Co.*, [1963] S.C.R. 154 examined the standard of proof to be applied in determining whether or not the appellant was "under the influence of intoxicating liquor to such an extent as to be for the time being incapable of the proper control of the automobile" within the meaning of a statutory condition contained in an automobile insurance policy.

On a cross-appeal, the respondent argued that the trial judge had erred in requiring that he be satisfied "beyond a reasonable doubt" that the appellant was intoxicated. Ritchie, J., delivering the majority judgment for the court, allowed the cross-appeal and having reviewed the authorities in which a "quasi-criminal" or criminal issue was raised in a civil suit stated at 164:

> Having regard to the above authorities, I am of the opinion that the learned trial judge applied the wrong standard of proof in the present case and that the question of whether or not the appellant was in a state of intoxication at the time of the accident is a question which ought to have been determined according to the "balance of probabilities".

In reporting whether I have discovered evidence tending to show persons have acted with an intent to "defraud" or "fraudulently or dishonestly" or for "a fraudulent or unlawful purpose" I have assessed matters on a balance of probabilities.

The "balance of probabilities" means that the evidence must be such that I can say that something is more probable than not. If I am undecided or the scales are equally balanced, absent the ability to draw any inferences, the fact in issue will not be stated to have sufficient evidence about it that it "tends to show", or is proven or disproven. I construe the mandate as imposing upon me a duty to indicate that I have discovered such evidence only where I am satisfied that the facts tending to prove or disprove those issues are more probable than not.

(c) *Citation of Evidence*

For the assistance of the court, I have provided page citations of transcripts and exhibits. The use of citations should not be taken as indicating that other evidence was not weighed and considered. I could not hope to identify by source every detail in the evidence which influenced my conclusions.

However, I have endeavored to set out references to evidence I believe to be particularly significant.

A note on my style in reporting the evidence may be helpful. I have been cautious to ensure that a person's evidence is fairly reported. On occassion a quotation of a segment of the transcript of the proceedings is set out, but more frequently testimony is incorporated into the text to facilitate its presentation. The style of reporting the evidence reflects the evidence as given, and where the evidence was unclear, the report of such evidence will reflect that. Those occasions upon which I can legitimately invoke this disclaimer should be easily identifiable by my attribution of the statements to a particular witness and by a citation of the source.

II. PROCEDURAL MATTERS

A. PROCESS

The Investigation established offices at 1700, 10025 Jasper Avenue, Edmonton, Alberta. The Investigation offices consisted of individual offices for myself, my counsel and legal staff as well as a reception area, secretarial stations, space for document storage and filing, and photocopying facilities. In addition, I was provided a boardroom with space sufficient to convene meetings, as well as extra private offices for counsel to brief witnesses and for consultants such as chartered accountants to work in. The hearing room, located in the same premises, provided seating in a "U-shape" configuration arranged around counsel tables. I sat at the top of the "U". All witnesses testified from a position immediately to my left. The original exhibits were kept in the hearing room and stored in filing cabinets as volume dictated.

The hearing room provided seating for 170 spectators. Two fixed locations for television cameras were provided. The public evidence was transmitted live on local cable television in Edmonton, and with a one-day time delay in Calgary. The cable transmission was also broadcast in British Columbia and elsewhere.

The impact of live television coverage upon the conduct of the hearings was of concern to me; concerns were also expressed by many counsel at the time of the decision to allow such coverage. One concern was the possibility of witnesses being intimidated or otherwise hampered in giving forthright testimony. Another concern was that counsel may also be affected, so as to conduct themselves as performers rather than as counsel.

I am of the view that such concerns proved unfounded and that witnesses and counsel were, from my perspective, unaffected by the television coverage. Due to the intense public interest at the time, I believe the decision to afford television coverage was the correct decision.

As is indicated in Chapter I, there were a number of court decisions in the Court of Queen's Bench of Alberta, the Court of Appeal of Alberta and the Supreme Court of Canada with respect to the interpretation of my mandate. Moreover, in carrying out my mandate, I was at all times subject to the supervisory jurisdiction of the Court of Queen's Bench of Alberta.

Mr. Justice Berger heard every application made by my counsel or by other counsel who participated on behalf of witnesses or interested parties at the public hearings with respect to the interpretation of my mandate, as well as with respect to any matter involving any procedure affecting any witness or interested party. Attached to this Report as Schedule A is a list of court orders made together with a brief description of their nature. These orders demonstrate that almost every facet of the public hearing process was governed by, or at least was subject to the supervision of, the court. As servant of the court, I am compelled to state that Mr. Justice Berger was always accessible, and his disposition of matters brought before him was just and expedient in a practical, yet fair, manner. In carrying out the terms of my mandate, I was mindful throughout of Mr. Justice Berger's careful and helpful instruction with respect to the requisites of fair play in action.

The relevant sections of the *BCA* concerning the supervisory jurisdiction of the Court of Queen's Bench are:

> 224(1) On an application under section 223 or on a subsequent application, the Court may make any order it thinks fit including, without limiting the generality of the foregoing, any or all of the following:

(a) an order appointing an inspector, fixing the remuneration of an inspector, or replacing an inspector;

(b) an order determining the notice to be given to any interested person, or dispensing with notice to any person;

(c) an order authorizing an inspector to enter any premises in which the Court is satisfied there might be relevant information, and to examine any thing and make copies of any document or record found on the premises;

(d) an order requiring any person to produce documents or records to the inspector;

(e) an order authorizing an inspector to conduct a hearing, administer oaths and examine any person on oath, and prescribing rules for the conduct of the hearing;

(f) an order requiring any person to attend a hearing conducted by an inspector and to give evidence on oath;

(g) an order giving directions to an inspector or any interested person on any matter arising in the investigation;

(h) an order requiring an inspector to make an interim or final report to the Court;

(i) an order determining whether a report of an inspector should be published and, if so, designating the persons to whom all or part of the report should be sent;

(j) an order requiring an inspector to discontinue an investigation;

(k) an order requiring any person other than the corporation to pay all or part of the costs of the investigation.

(2) Unless the Court otherwise orders, an inspector shall send a copy of his report to the corporation.

(3) Unless the Court otherwise orders, the corporation shall pay the costs of the investigation.

(4) Any interested person may apply to the Court for directions on any matter arising in the investigation.

225(1) An inspector under this Part has the powers set out in the order appointing him.

(2) In addition to the powers set out in the order appointing him, an inspector appointed to investigate a corporation may furnish to, or exchange information and otherwise cooperate with, any public official in Canada or elsewhere who is authorized to exercise investigatory powers and who is investigating, in respect of the corporation, any allegation of improper conduct that is the same as or similar to the conduct described in section 223(2).

(3) An inspector shall on request produce to an interested person a copy of any order made under section 223 or 224(1).

226(1) A hearing conducted by an inspector shall be heard in camera unless the Court otherwise orders.

(2) An individual who is being examined at a hearing conducted by an inspector under this Part has a right to be represented by counsel during the examination.

227 A person shall not be excused from attending and giving evidence and producing books, papers, documents or records to an inspector under this Part on the grounds that the oral evidence or documents required of him may tend to criminate him or subject him to any proceeding or penalty, but no such oral evidence so required shall be used or is receivable against him in any proceedings thereafter instituted against him under any Act of Alberta.

The preamble to section 224(1) indicates that the "Court may make any Order it thinks fit". In describing procedural matters below, I will refer to the matters which were the subject of court rulings and decisions, as well as some matters which were ruled upon by myself or agreed to by counsel and not taken before the court. Mr. Justice Berger made it clear that any interested party had full and free access to him at all times with respect to any procedural matter.

My counsel called periodic meetings of the lawyers representing interested parties at the public hearings to discuss and seek agreement upon various matters involving document production and the procedure to be followed at the public hearings. Eight such meetings occurred: in August, September, October, November and December, 1987 and in May, October and November, 1988. Copies of the minutes of counsel meetings 1-8 are in Schedule B at the end of my Report.

The counsel meetings dealt with all facets of conducting public hearings, including the issues of whether or not to allow television and still cameras into the hearing room; document production and access of counsel for interested parties; and, production of documents to my counsel prior to their being tendered in evidence.

Beyond the terms of my mandate and their interpretation, as reported on in the preceding chapter, the court indicated that I was to be the master of procedure in my investigation, absent a dispute. The disputes were many, but on the whole centered upon legitimate differences of opinion. Where counsel were not content with my rulings, disputes were resolved by rulings of the court.

As can be seen from Schedule B, I attended very few meetings of counsel. I neither saw nor reviewed any document relevant to the matters before me prior to it being tendered in evidence at the public hearings, with the exception of some investor letters addressed to me. My Report is based solely on the evidence lead before me at the public hearings. As I stated at the outset, I followed the rules of evidence as closely as possible unless counsel agreed to relax the rules. It was always open to any counsel to object to the manner in which evidence was being lead by my own counsel or by others. Often the admissibility of documents was put in issue and was the subject of my ruling, and sometimes a subsequent ruling of the court. Similarly, whether or not a witness was obliged to answer questions was sometimes put in issue and ruled upon by me, subject to appeal to the court.

The reason for following the rules of evidence, unless relaxed by agreement of counsel, was to ensure fundamental fairness in the procedure for all interested parties. Although I have no power to make any determinations of civil or criminal liability, the objective of fair play in action was pursued throughout and, I think, achieved, in part as a result of the adversity of interests represented by capable counsel.

In this context, my counsel had my full authority to call whatever evidence he saw fit. My mandate was to indicate whether I had discovered evidence tending to show certain matters, as outlined in the previous chapter of this Report. The evidence I heard was not directed by me but by my counsel in conjunction with his discussions with other counsel for interested parties.

B. DOCUMENT PRODUCTION

I am informed by my counsel that the documents in the possession of the Government of Alberta were made available to my legal staff, who undertook an assessment of their relevancy. Hundreds of thousands of documents were reviewed including documents from the Department of Consumer and Corporate Affairs, Alberta Treasury and the Alberta Securities Commission, covering the years 1948 to June 30, 1987. As matters progressed, new issues arose requiring additional documentation. I am informed by my counsel that the Government of Alberta cooperated completely and promptly in making documents available. The documents reviewed included files of present and former Ministers and their Deputies, Cabinet agendas and Cabinet minutes from 1975 to 1987, as well as minutes of the Priorities, Finance and Coordination Committee of Cabinet.

The corporate records in possession of the Receiver and Manager of FIC and AIC, the Trustee in Bankruptcy of PGL and the Liquidator of PS&T were also made available for inspection. As well, senior corporate officers of those companies produced documents which remained in their possession following June 30, 1987. Much of the corporate documentation was located on premises occupied by Metropolitan Group, the purchaser of some of the assets of PGL. Executives of Metropolitan Group and their counsel cooperated fully with the Investigation in the production of relevant documentation and in providing access to computerized records.

Other witnesses who were no longer associated with the companies or who were never associated with the companies, such as investors, also produced extensive documentation prior to giving evidence.

All documentation was made available to counsel for interested parties or witnesses attending the hearings upon a solicitor's undertaking, simply stated, not to disclose the contents of documents reviewed by them to the media or to the public in any way, except for the purpose of taking instructions from their own clients prior to the document being put in evidence at the public hearings. I know of no case where this undertaking was breached.

In many instances it was necessary for my counsel to appear before the court to seek production of particular documents. My counsel indicated that Canada Deposit Insurance Corporation ("CDIC") documents were necessary in order to fully examine the relationship between CDIC, PS&T and the Alberta regulators. Those documents included correspondence, notes or minutes of meetings and other communications among officials of CDIC, FIC, AIC, PGL, PS&T and the Government of Alberta. The Court of Queen's Bench ordered production of the documents. That order was upheld, with some variation, by the Court of Appeal. The documents were produced, subject to any legitimate claims of privilege.

Proceedings were undertaken with respect to certain current or former employees or agents of the Government of British Columbia within the office of the Superintendent of Brokers to issue *subpoenae duces tecum* pursuant to the *Interprovincial Subpoena Act*, S.A. 1981 c. I-8.1, as amended, the target being documents relating to communications between the Government of British Columbia, FIC and AIC and the Government of Alberta. The application to the Court of Queen's Bench was not successful. However, the Government of British Columbia voluntarily produced relevant documents, and witnesses from the Superintendent of Brokers' office testified with respect to those matters at the public hearings.

Information and documentation was also sought and obtained from numerous brokerage houses in Canada with respect to the trading of shares in Matrix and PNI. In certain instances *subpoenae* were issued and certificates obtained pursuant to the *Interprovincial Subpoena Act*, *supra*.

I am advised that my counsel also had access to and reviewed the files, including the working papers, of the auditors Touche Ross & Co. and Deloitte Haskins & Sells related to audits of PGL, FIC, AIC, PS&T, and PCL. The files in the possession of Coopers & Lybrand, auditors of CSL, CSI and CIL, were also made available, as were the files in the possession of Deloitte Haskins & Sells relating to EL&F. In addition, court orders for the production of documents were obtained, directed at the Canadian Imperial Bank of Commerce and the Royal Bank of Canada, who were the respective custodians of the assets of AIC and FIC pursuant to the *ICA*. My legal staff attended at the premises of both banks to review that documentation.

Documents were tendered in evidence through witnesses on the basis that they were producing documents they had authored, received or reviewed in the course of their involvement with the matters in issue, or that otherwise pertained to them.

Documents intended to be tendered in evidence through a particular witness were set out in a counsel ante-room and made available to counsel for all interested parties, upon their signing a solicitor's undertaking, prior to the witness testifying. On occasion objections were taken to some of the contents of proposed exhibits and in some cases those matters were worked out among and between counsel by agreement. In other cases, no agreement was reached and my ruling was sought; in some cases ultimately a ruling of the court was necessary. For example, the "Simulated Earnings Analysis" [Exhibit 622] in the report of Gordon Barefoot of Woods Gordon, an expert witness engaged by my counsel, was objected to by counsel for the Cormie family. It was ultimately admitted in evidence, following my ruling and a subsequent ruling of the Court of Queen's Bench.

A total of 637 exhibits were entered into evidence during the hearing. I estimate the average length of an exhibit to be 200-300 pages.

C. ORAL EVIDENCE

My counsel lead all of the witnesses in direct examination in the first instance, with the exception of expert witnesses called by counsel for other interested parties and one or two other witnesses.

I am informed by my counsel that he took suggestions as to witnesses who might be called in addition to those he called initially. In the event of a disagreement between my counsel and counsel for other interested parties, the latter were advised that they were at liberty to apply to Mr. Justice Berger for an order directing that a witness be called. Any witness from whom an interested party wanted evidence was called and testified. No court applications were made to compel me to allow the attendance of witnesses.

The preparation of witnesses called by my counsel, I am informed, proceeded invariably on the following basis. First, every witness was advised that he or she was entitled to be represented by counsel. In all cases where witnesses were represented by counsel, with very minor exceptions and then only upon the consent of the witness' counsel, my counsel at no time briefed the witness separate and apart from their counsel, and that their counsel was continuously present throughout all briefing of the witness in preparation for testimony.

Counsel appearing at the Investigation had the right to cross-examine witnesses. Expert witnesses called by an interested party were lead in the first instance by counsel for the party calling the witness. In addition, each of those parties was advised that, should they wish any particular witness called or their own client recalled, they were to refer the request to my counsel for consideration. Marlin was the only witness to exercise that right.

On two occasions, evidence was given by way of statutory declaration. On each occasion, the consent of all parties who were continuously represented at these proceedings was obtained.

A total of 154 witnesses testified before the Investigation. A list of their names is in Schedule N.

Public hearings commenced on October 14, 1987 at the Investigation offices and continued for 206 days, closing on December 13, 1988. Argument was presented subsequent to the close of evidence.

Pursuant to the orders establishing the Investigation, all of the hearings were held in public except where the evidence could be reasonably expected to impair the efficient liquidation of FIC, AIC and their affiliates. Brief *in camera* evidence was heard on one occasion in relation to the values of certain properties within the portfolios of FIC and AIC.

In keeping with the public nature of the proceedings, the transcripts of the proceedings and the exhibits filed were made available to the public. Owing to the intense public interest, broad news coverage by the media, and live television, witnesses were not excluded from the hearing room prior to giving evidence, and no counsel applied for such exclusion.

Numerous persons were interviewed by the legal and accounting staff of the Investigation but were not called to testify. I have not reviewed any notes of such interviews, nor have I been advised of the substance of the interviews.

The hearings opened with evidence from investors in the products of FIC, AIC and PGL. They were followed by the evidence of salesmen. In the case of investors and salesmen, witnesses were chosen by my counsel from across Canada. The Investigation then proceeded to hear evidence from the management of the companies, following, in most cases, the corporate hierarchy, starting at the bottom and moving up. Evidence was given by the former external auditors of FIC, AIC, PS&T, PGL and PCL. Thereafter, regulators from the Governments of Alberta and British Columbia testified, again tracking, in most instances, the hierarchy of authority from bottom to top. The hearings then proceeded to testimony from expert witnesses, and concluded shortly thereafter.

As the transcripts became available, they were placed on a computer searching system. In the case of those interested parties known not to have access to such facilities, my staff made the Investigation's computer facility and an operator available to assist them in locating information contained within the transcripts.

Some 207 volumes of transcripts were generated, totalling approximately 38,267 pages.

D. ARGUMENT

Every party represented at the Investigation was given the opportunity to present written argument, followed by oral argument and a written reply. Written arguments were filed by February 13, 1989. Written replies were filed by March 13, 1989. The written materials were released to the public on April 21, 1989 pursuant to the order of Mr. Justice Berger. Supplementary written argument was requested by me in late May, 1989 and received in June, 1989 on the issue of whether or not a single pay term certificate issued by FIC or AIC is an investment contract within the terms of the *ICA*.

Following the conclusion of argument, I conducted a review of the evidence to determine whether the substance of evidence which may adversely impact upon a witness had been put to that witness. Having concluded that the substance of certain evidence may not have been put to witnesses, I issued notices to such witnesses in order to provide them with a full and complete opportunity to respond. No witness receiving such notice responded requesting to testify.

E. EXPERTS

The Investigation retained the services of chartered accountants, Clarkson Gordon, and management consultants, Woods Gordon, who assisted with respect to complex accounting, auditing and business management issues. Clarkson Gordon assisted in the preparation of summaries of the intercorporate transactions which were introduced into evidence. Clarkson Gordon also assisted in the assessment of relevancy in relation to audit working papers produced and assisted in briefing the evidence of the former auditors of PGL, FIC, AIC, PS&T and certain of the Alberta regulators. They also prepared expert opinions.

John Kolosky was engaged as an expert in stock market operations qualified to identify manipulation and prepare an opinion on the share trading of Matrix. He was called as a witness by my counsel, as was Richard Cormier of Clarkson Gordon and Gordon Barefoot of Woods Gordon. The opinions prepared by expert witnesses engaged by my counsel were all the subject of testimony given by them, regardless of whether the opinion favoured any interested party one way or the other and so long as the opinion evidence touched on the matters in issue. The experts engaged by my counsel were subject to cross-examination as to both their qualifications and the substance of their evidence.

Experts called on behalf of the Cormie family included a real estate appraiser, an economist, and a chartered accountant. Counsel for the Cormie family lead that expert evidence and it was subject to cross-examination as to both qualifications of the witnesses to offer opinions, and the substance of the evidence. Counsel for certain senior management called an expert witness in the field of stock market operations on the same basis.

F. COUNSEL

Throughout this section I refer to my counsel periodically. It should not be taken that I am referring only to Mr. Wittmann. Each of Ms. Taylor, Ms. Skene and Mr. Eamon participated in the hearings by leading the evidence of some witnesses. As well, Ms. Sigurdson, in conjunction with the rest of my legal staff, participated in writing of the final Report pursuant to the reasons for judgment and order of Mr. Justice Berger of November 15, 1988 to the effect that my counsel and my legal staff were to assist in the writing of the final Report, provided that the findings or conclusions were mine and mine alone. They are.

G. INTERIM REPORT AND FINAL REPORT

An interim Report was issued on September 30, 1987. The initial due date of the final Report was February 13, 1988. It was estimated that an extension to June 13, 1988 would be sufficient to complete the public hearings and final Report. It became apparent that this date could not be met and accordingly, the date of the final Report was extended to September 13, 1988. At that time hearings were still progressing with the result that there was an extension of the final due date for the Report to within 60 days of the filing of reply argument. Due to sheer volume and complexity of the evidence it became apparent that this due date could not be met and a further extension to July 6, 1989 was obtained, and subsequently amended to July 18, 1989.

III. CORPORATE OVERVIEW

The Investigation focused on two companies, FIC and AIC. These two companies operated as part of a group of companies known as the "Principal Group of Companies" or "Principal Group" or "Principal". In order to understand the nature of FIC and AIC, their operation and ultimate failure, it is necessary to understand how the Principal Group of Companies operated, since the business and affairs of its members were inextricably interwoven. The failure of FIC and AIC was followed by the collapse of other members of the Principal Group of Companies, including the parent company, PGL, and the trust company, PS&T.

A. PRINCIPAL GROUP OF COMPANIES

The Principal Group of Companies ("Group") was intended to provide complete one-stop personal financial services to customers. It was referred to in the 1973 Annual Report of PGL, the earliest annual report tendered in evidence, as "The Department Store of Finance". [Exhibit 186] In the 1976 Annual Report of PGL it was described as follows:

> The Principal Group of Companies is a diversified group of financial companies. The Group offers Thrift services, Trust services, Mutual Fund services, Life Insurance services, Specialized Tax services, Mortgage services and Investment Advice and Management services.
>
> The Principal Group of Companies is dedicated to the principle of establishing a "one-stop financial center." Services are marketed through retail centres and directly by a field force. [Exhibit 186]

The Group was founded in 1954 on the concept of "thrift", that is "Pay yourself first" and "10% of everything you earn is yours to keep". [Exhibit 11] The idea was to encourage individuals to regularly set aside small sums which over a period of time would grow or accumulate into a significant asset. According to Donald Cormie, the idea arose out of a conversation he had with Ralph Forster, then with the World Bank, during a football game in Edmonton. Both had always tried to save at least 10% of what they earned. The conversation turned to forming a company that sold the concept of thrift; eventually with the assistance of three other Edmonton businessmen they did just that. Bankers Investment Corporation, which later became First Investors Corporation Ltd. ("FIC"), was incorporated in 1954 and was the first company in the Group. [Exhibit 186]

In 1962 Associated Investors of Canada Ltd. ("AIC"), which was incorporated in 1948, was acquired and became part of the Group. [Exhibit 186]

Both FIC and AIC provided "thrift services" through the sale of investment contracts to investors. An "investment contract" is defined in s.1(c) the *Investment Contracts Act*, R.S.A. 1980, c. I-10, as amended ("*ICA*") as follows:

> 1(c) "investment contract" means a contract, agreement, certificate, instrument or writing containing an undertaking by an issuer to pay the holder thereof, or his assignee or personal representative or other person, a stated or determinable maturity value in cash or its equivalent on a fixed or determinable date, and containing optional settlement, cash surrender or loan values prior to or after maturity, the consideration for which consists of payments made or to be made to the issuer in instalments or periodically, or of a single sum, according to a plan fixed by the contract, whether or not the holder is or may be entitled to share in the profits or earnings of, or to receive additional credits or sums from, the issuer, but does not include a contract within the meaning of the *Insurance Act*.

FIC and AIC were registered as issuers in Alberta under the *ICA* and in certain other provinces under similar legislation.

From their inception until 1978, FIC and AIC offered accumulation savings plans as their primary products. In 1978 the marketing strategy of FIC and AIC changed, and they began offering highly competitive, single payment investment certificates. [Exhibit 186] This was a very significant product shift or change which will be examined later in this Report.

In 1965 Principal Savings and Trust Company ("PS&T") was incorporated to provide trust and fiduciary services. PS&T also acted as trustee of the Group's RRSP products. [Exhibit 186] In Alberta, PS&T was regulated under the *Trust Companies Act*, R.S.A. 1980, c. T-9, as amended. In accordance with s.159(4) of that Act, PS&T had to acquire CDIC insurance in order to be registered as a trust company in Alberta.

On August 10, 1987 the Director of Trust Companies took possession and control of PS&T's assets pursuant to the *Trust Companies Act*. [Exhibit 363 at 328] Shortly thereafter, CDIC applied for a winding-up order under the *Winding-up Act*, R.S.C. 1985, c. W-11 and B.I. Robertson & Associates Ltd. was appointed as Liquidator. [5648; 32659]

In 1966 Principal Group Ltd. ("PGL") was incorporated. [Exhibit 630 at 62] PGL was considered the parent company in the Group. It provided management and other services to the other members of the Group and also sold promissory notes. [36116]

PGL made a voluntary assignment into bankruptcy effective August 10, 1987. [36088-9; 36109] J. Stephens Allan of Collins Barrow Ltd. was appointed as Trustee.

The first mutual or investment fund, Collective Mutual Fund Ltd. ("CMF") was introduced in 1963. That was followed by Principal Growth Fund ("PGF") in 1967 and Principal Venture Fund Ltd. ("PVF") in 1969. In 1979 Principal Bond Fund ("PBF") was introduced to take advantage of all-time high interest rates. [Exhibit 186] In 1982 Principal World Fund, Inc. ("PWF") and Principal Equity Fund Inc. ("PEF") were introduced. In 1985 Principal Canadian Mutual Fund Ltd. ("PCF") and Principal Multiplier Fund ("PMF") were introduced. [25054; Exhibit 11]

In 1970 Principal Consultants Ltd. ("PCL") was incorporated to distribute and sell most of the Group's services and products, including FIC and AIC investment contracts, the various mutual funds, PS&T term deposits and services and PGL promissory notes.

In 1976 Principal Securities Management Ltd. ("PSML") was incorporated to provide investment services to the Group. PSML remained part of the Group until 1984. It was the investment manager for the mutual funds and for the investment portfolios of the members of the Group.

In 1983 PGL acquired controlling interest in Bomac Batten Limited, a printing and computer graphics company listed on the Toronto Stock Exchange. During 1984 the company was reorganized and emerged as Principal Neo-Tech Inc. ("PNI"). [Exhibit 186]

PGL owned 100% of PCL, FIC, AIC and, until August 15, 1984, PSML. [Exhibit 267] PGL owned 100% of the voting shares of PNI up until June 6, 1986. [6977] PGL owned shares of the incorporated mutual funds. Other mutual funds were established as trusts, in which case PS&T was trustee. PGL also owned 94.3% of PS&T. [Exhibit 630]

Donald Cormie testified that "Principal Group" meant many different companies and had no singular meaning. [17878-83] Subsequent to the economic problems encountered by the Group, corporate publications such as the 1985 Annual Review [Exhibit 11] referred to the Group as encompassing many other companies in addition to those mentioned below. This, the evidence tends to show, was misleading. The evidence tends to show that when the terms "Principal Group of Companies", "Principal Group", "Principal" or "Group" were used by Donald Cormie, they were meant to cover PGL, FIC, AIC, PS&T, PCL, PSML and the mutual funds.

B. FUNCTIONAL MANAGEMENT

None of the companies in the Group operated as independent entities. Rather, the Group was run on a functional basis whereby sales, administration, accounting, investment and other management functions were provided to or performed for each member of the Group by particular "departments" of PGL or sometimes by a corporation acting under the direction of PGL.

Certain of these functions were performed pursuant to written agreements, others were not. This will be detailed elsewhere in the Report. The advent of functional management was described in PGL's 1976 Annual Report as follows:

> In 1972, Principal experimented with decentralized management to allow subsidiary companies to develop their own management groups. The aim was to engender a competitive management atmosphere and provide a basis for comparative analysis by the Board of Directors of Principal Group Ltd.
>
> It became apparent that Principal was not of a size to duplicate major management functions in an environment of rapidly escalating costs and wages. Techniques for surveying and monitoring the financial industry and internal analytical models developed by the Information Services Department provide unique new tools for measuring performance. As a consequence, in its 1976 business plan Principal formally adopted a functional management structure.
>
> Broadly speaking, Principal's Management is divided into three major areas: "money in," "control and administration," and "money out." [Exhibit 186]

"Money-In" meant sales and included the thrift services provided by FIC and AIC. Money was taken in by the sales or field force employed by PCL, primarily through retail one-stop "Principal Financial Centres", PS&T branches and PCL offices.

"Control and Administration" involved administration and information functions. It included the provision of financial information, control of Group policies and procedures, monitoring of cash flow and budgets, reporting on compliance with regulatory requirements and internal audit.

"Money-Out" concerned investment.

These broad functions were managed by various departments within PGL, each headed by a PGL Vice President. In certain instances the departmental function was actually carried out by a particular corporation in the Group, however the function was still directed by the PGL department, and in such cases the PGL Vice President who ran the department was also the President of the corporation.

The specific functions within the three major areas included the following:

Sales — The selling function for the Group was carried out by PCL; it was responsible for the field organization and operations. It employed, instructed and managed the sales force. The Sales Department of PGL provided management services to PCL. [Exhibit 186]

At all relevant times, Marlin was responsible for "Money-In". [11576-7] He was Executive Vice President, Sales of PGL and was also President of PCL, FIC and AIC.

Moulton held the position of Vice President, Field Operations of PCL from 1985 to 1987, although he was paid through PGL. [4524; 4532; 4834]

Marketing — The marketing function for the Group was carried out by the Marketing Department of PGL. It was responsible for developing the most cost effective ways of bringing funds into the Group. Specific responsibilities included advertising, public relations, direct mail marketing and the opening of Principal Financial Centres. The Marketing Department produced a variety of literature including newsletters, promotional and informational materials for the sales force, PGL annual reports, the 1985 Annual Review and annual and semi-annual reports on the mutual funds. [Exhibit 186]

During the late 1970s and early 1980s, John Hickey was Vice President, Marketing of PGL. On July 1, 1986 John Ritchie assumed that position and held it until August, 1987. [5032; Exhibit 255 at 1] In the interim between their respective terms a variety of individuals assumed some responsibility for marketing services.

Corporate Development — The Corporate Development Department of PGL assisted the Chairman of PGL, Donald Cormie, in analyzing and implementing new business opportunities for the Group. Specific functions included ensuring that treasury, security transactions and banking functions utilized the most technologically advanced systems to obtain increased yields and decreased costs. [Exhibit 186] It also took on specific projects from time to time as required within the Group. [9808-9]

Petracca was Vice President, Corporate Development of PGL from 1980 until 1987. [9796; 36109-10]

Finance — The Finance Department of PGL was responsible for providing timely information to management on all aspects of the Group, recording the assets of the Group, providing timely reporting of financial data to the regulators and dealing with tax matters. Specific responsibilities included general accounting, customer accounting, computer information systems and coordination of the annual audit with the external auditors. [Exhibit 186; 6182; 7415-6]

Johnson was Vice President, Finance of PGL from 1984 to 1987. [Exhibit 266 at 1] He testified that by reason of that position, he was also the chief financial officer of FIC, AIC and PS&T. [7411]

Operations — The Operations Department was created in 1984 in response to the Group's rapid growth, to ensure stability and consistency within the Group. It was intended to provide centralized corporate management of internal strategies and policies. Specific responsibilities included monitoring achievement of objectives and allocation of resources. It was also responsible for internal audit. [Exhibit 186]

Mitchell was Vice President, Operations of PGL from 1984 to 1986.[5767; 5772]

Legal — The Law Department of PGL provided general counsel to all members of the Group. Specific responsibilities included corporate and regulatory filings, prospectus preparation, new product documentation, interaction with the various boards of directors on the development and implementation of policy and interaction with outside counsel. [Exhibit 186]

Patrick was Senior Vice President and General Counsel of PGL from 1983 to 1987. [Exhibit 350 at 2]

Trust — The Trust Services Department of PGL was responsible for the trust function, which was actually carried on through PS&T. [Exhibit 186]

John Cormie was Vice President, Trust Services of PGL and was also the President and a Director of PS&T from 1977 to 1987. [8995]

Investments — The Investment Department of PGL performed the "Money-Out" function of the Group and provided investment services for the mutual funds, the other members of the Group and certain other large managed accounts. It really consisted of the Stock and Bond and Mortgage Departments. [Exhibit 186]

James Cormie was Vice President, Investments of PGL from 1978 to 1987. [13698-700]

Stocks and Bonds — The Stock and Bond Department of PGL was originally responsible for managing virtually all corporate and managed funds. In 1976 that function was reorganized under PSML. The reason stated in the PGL 1976 Annual Report for incorporating a new company to assume the investment function was to avoid what were considered to be retrograde changes in the *Trust Companies Act* which inhibited the management functions of Alberta trust companies. [Exhibit 186]

James Cormie was Manager of the Stock and Bond Department from 1976 to 1978. From 1976 to 1987 he was the President and a Director of PSML, in addition to being the Vice President, Investment of PGL. [13698-700; Exhibit 409 at 1]

Pearce was Vice President, Finance of PSML from September, 1986 to August, 1987. [Exhibit 328 at 2]

Mortgages — The Mortgage Department of PGL was responsible for administering the mortgage lending and the Group's portfolio of residential and commercial mortgages and real estate. [Exhibit 186]

Green was Mortgage Manager from 1968 or 1969 to 1976. [5583] Fuhr was Mortgage Manager from 1977 to 1983. [22850] Green returned as Mortgage Manager from 1983 to 1987. [5595-6] There was no Vice President, Mortgages of PGL; the Mortgage Manager, who was not a vice president, reported to James Cormie as Vice President, Investments.

In addition to the functional departments of PGL, there were a number of management committees in existence which assisted in setting policies and strategies. These committees, which usually met once a week, included the Sales Committee, Investment Committee, Mortgage Investment Committee (which was not established until after mortgage lending ceased), Control Committee, Group Vice Presidents Committee and the Audit Committee. Apart from the Mortgage Investment Committee, all were chaired by Donald Cormie. [6185-93]

Within the functional structure, management was said to be carried out "by objective", a technique introduced by Donald Cormie in the 1970s. [15863] At the annual Victoria Planning Conferences senior management would discuss overall strategies and policies for the Group and set department objectives for the coming year. Action plans would be formulated. Once back in Edmonton, each department would refine the objectives further, in conjunction with the Operations and Finance Departments. The final objectives, as approved by Donald Cormie, would be circulated by the Operations Department, which would distribute quarterly updates assessing each department's progress towards their achievement. [3761; 5889; 9850; Exhibit 368 at 151]

C. CONTROL OF THE GROUP BY DONALD CORMIE

The evidence shows that Donald Cormie controlled the Group through his controlling shareholding in PGL and the offices he held in PGL.

By 1980, PGL was owned 100% by Collective Securities Ltd. ("CSL") which, in turn was owned 80.5% by Donald Cormie, 10.5% by Marlin through a management company and 4.5% by each of James Cormie and John Cormie. By virtue of a corporate reorganization on September 1, 1985 PGL came to be owned 100% by Collective Securities Inc. ("CSI"), which also owned 100% of Athabasca Holdings Ltd. ("AHL"). CSL owned 80.5% of CSI and was in turn owned 100% by Donald Cormie. Accordingly, throughout the 1980s Donald Cormie had an effective 80.5% ownership interest in PGL.

Donald Cormie was also the President and Chairman of the Board of PGL from its inception in 1966 until its bankruptcy in August, 1987. The various functional Vice Presidents of PGL reported directly to Donald Cormie. As will become apparent, Donald Cormie was the only individual familiar with and involved in every aspect of the operations of the Group. It is clear that Donald Cormie set the corporate objectives of the Group.

In addition to being the majority shareholder and a "hands-on" manager, Donald Cormie controlled the Group through his control of the Group's budget. The total budget was required to be and was approved by him. He determined and monitored expenditures of the various members of the Group and the departments of PGL. Decisions that involved or impacted on more than one company or department required his approval prior to implementation. Any expenditures in excess of any department budget had to be approved by him. [5069-70; 5875-7; 6987-9; 11379-81; 13392-3; 13395-8; 15408-14; 15977-8; 16035-6; 16435; 16459; 16750; 23562-623; 23697-8; 23707; 23712]

Donald Cormie testified that he left the running of the companies in the Group to his Vice Presidents and to the directors of the various companies, and that only in the case of conflict did he make decisions affecting the various departments.

This evidence is not consistent with the evidence of the various Vice Presidents, except sons James Cormie and John Cormie. Nor is it in accord with certain of the documents tendered in evidence or with common sense, given Donald Cormie's effective 80.5% ownership of the Group.

Marlin testified that Donald Cormie was in effective control of the companies; that he was the ultimate decision-maker and it was his company. [11596] Mitchell said the same thing, as did Ritchie and Johnson. [5908; 4932; 6195; 7143]

I feel compelled to comment at this point on Donald Cormie's evidence and his manner of giving that evidence. As the central figure in the Group, I expected Donald Cormie to provide the key evidence as to the operations of these companies, but this proved not to be the case. For the most part, Donald Cormie was more interested in acting as his own counsel and in arguing than he was in giving evidence. He continually evaded answering questions and, when answering, gave argument rather than facts. Numerous occasions will be pointed out in this Report where Donald Cormie changed his evidence depending upon his view of how it would best serve his interests. The following passages from Donald Cormie's evidence are instructive:

> Q Then, sir, we should conclude, I take it, that we can not tell in reading any given answer whether it is accurate or whether it is confused as a result of pressure or information overload or whatever?
>
> A Well, you would have to look at every single question and answer.
>
> Q We wouldn't be able to know in advance, we would have to consider each one separately, is that it?
>
> A Yes, in some cases, they require certain explanation. [20948]

And further:

> Q Well, in the context of this article, you adopt this as a candid statement?
>
> A I don't understand what your word 'candid statement' means.
>
> Q Do you not know what 'candor' is?
>
> A It depends on the circumstances you're using it. What are you using it for?
>
> Q Candor is —
>
> A If you're talking to yourself with the wall, you could make a statement and you can say anything you want.
>
> Q When we're talking with our customers, sir.
>
> A Well, we're not talking with customers here.
>
> Q This isn't going to customers?
>
> A Well, I don't know. This is an Annual Report.
>
> Q It's not going to the customers?
>
> A Yes, it could — yes, this one would have gone to customers, the Annual Report.

Q	All right. So now, do you understand what 'candor' means in this context?
A	Your use of the word 'candor' is to try and bring some all-encompassing concept over into a statement that makes it kind of a universal application. I don't understand that.
Q	Can we try 'true'? Can we try 'true'? Is it a true statement?
A	Well, it depends on what it's being used for.
Q	Okay, accurate.
A	It could be a piece of a wider statement. I'm accepting it for what it says. For you to ask me whether it's true or candid —
Q	How about accurate?
A	Well, even accurate, it depends on what it's used for. [21555]

And further:

Q	Earlier this morning you mentioned that you did not recall suggesting that Jude Halvorson was not skillful in a business way. I would like to refer you, Mr. Cormie, to page 18053 of the transcript of your evidence. I shall read halfway through line 4 wherein you state, "The usual practice was that if the people, like Jude was not independently skillful, you might say, they would just take the advice and sign it." Was that evidence that you gave under oath, sir?
A	Yes, I believe that's correct. You are quoting from it, I think, aren't you?
Q	Yes. Was that evidence true?
A	Yes, that would be the practice. Did I say it was the practice?
Q	The evidence was true in terms of your view of Jude Halvorson not being independently skillful?
A	I think I should make it clear. I figured out the other day that it has almost been two months since I started here. I have had 6,000 minutes of asking questions, a question a minute. I've had 6,000 answers. I can't possibly remember every answer that I have given in this hearing. I couldn't possibly remember them.
Q	You don't have to, sir, if you tell the truth.
A	I am trying to, as best I can, so if you want to go back to another answer that requires a fuller explanation, then I will have to give you a fuller explanation.
Q	Well, I emphasize, sir, you don't have to remember your answers if you stay with the truth.
A	Well, that is easy to say, but sometimes your memory is jogged by something at that time, which it isn't now. [20123-5]

D. THE COLLECTIVE AND OTHER COMPANIES

In addition to the Principal Group of Companies, Donald Cormie also controlled another group of companies referred to as the Collective or "upstairs" companies.

Reference has already been made to Donald Cormie's majority interest in PGL through CSI and CSL. AHL and, after August 15, 1984, PSML were wholly-owned subsidiaries of CSL and later CSI. In June, 1986 ownership of PNI was transferred to CSL.

Through AHL, Donald Cormie acquired control of Matrix Investments Limited ("Matrix"), a public company listed on the Alberta Stock Exchange, in 1984. At the time of acquisition, Matrix was a mostly inactive oil and gas company. Subsequently, its stated goal according to the 1985 Annual Review was to acquire businesses based on undervalued assets, turnaround potential or viable new market opportunities. One of its first acquisitions, as the result of foreclosure on a FIC and AIC mortgage, was a small brewery in Red Deer, Alberta. It also acquired some oil and gas holdings from an affiliate, but not much else. [Exhibits 186 and 281; 7667-8; 7691]

Further, through CSL Donald Cormie owned 100% of Northwest International Bank & Trust Company (the "Bank") and Cormie Ranch Inc. ("CRI").

Pearce was Vice President of CSL from December, 1984 to August, 1987. [Exhibit 328 at 1; 7658]

Reference is made in this Report to County Investments Ltd. ("CIL"). As detailed below, the evidence tends to show that Donald Cormie controlled CIL, although the shares were actually held by persons unrelated to any one of the Cormie family or Marlin.

Reference will also be made to Estate Loan & Finance Ltd. ("EL&F"). That company was owned 100% by Eivor Cormie, Donald Cormie's wife. The evidence tends to show that EL&F was effectively controlled by Donald Cormie.

These companies are important for several reasons. Funds and other assets from the Group were loaned or otherwise transferred "upstairs" to them, and they were involved in many of the intercorporate transactions examined in this Report.

Appended hereto as Schedule "C" is Exhibit 305 from the hearings, which accurately shows the relationship of the various companies which are referred to in this Report except for CIL. All of the relevant companies for the purposes of this Report were under the control, direct or indirect, of Donald Cormie as at June 30, 1987.

Appended hereto as Schedule "D" is a summary of those individuals who were directors of the above-referenced companies.

IV. MONEY-IN

A. INTRODUCTION

"Money-In" involved marketing and was the function by which money was brought into the Group through the sale of products and services offered by its members. The products included FIC and AIC certificates, mutual funds, PS&T term deposits and PGL promissory notes. They were sold by salesmen or "financial consultants", primarily through retail one-stop "Principal Financial Centres" and PCL offices.

In this chapter I will examine how the "Money-In" function worked; how it was organized and managed, the sales strategies pursued by the Group and the sales practices used to sell the products, in particular FIC and AIC certificates.

B. THE PRODUCTS

Accumulation Certificates

Accumulation certificates issued by FIC or AIC promised to pay a sum certain in money at the end of the term provided the investor made regular periodic payments, usually monthly. These certificates had a cash surrender value and usually a penalty for termination before maturity.

Interest paid on accumulation plans was of two types. The investor was promised a fixed or "guaranteed" rate of 4% and could also receive "additional credits" or additional interest as declared and paid at the discretion of the directors of FIC and AIC.

Originally, accumulation certificates constituted the bulk of the certificates sold by FIC and AIC. After 1978 their sale declined dramatically as the result of a marketing strategy discussed below.

Single Pay Certificates

With single pay certificates issued by FIC or AIC an investor made a single payment and invested for a term of years, usually 1 to 10. Two basic types of certificates were offered:

1) Single pay certificate with a fixed or "guaranteed" component of 4%, plus additional credits (available for terms of 1 to 10 years). The fixed rate never changed; it was always 4%. [4108-9]
2) Single pay certificate with a fixed return and no additional credits (available for terms of less than 1 year). [Exhibit 264 at 34]

From time to time other versions of single pay certificates with particular features were offered.

The evidence tends to show that the regulators would not allow single pay certificates with additional credits to be advertised (for example, in newspapers) because the rate of return was not certain. [9071-3; 9566-7] Because of the absence of additional credits and therefore certainty of return, short term single pay certificates could be advertised and it appears that was the reason for the introduction of that type of certificate in 1983. [2648-51; 9897-9]

The rates at which additional credits would be paid were set out on "rate sheets" issued by the Sales Committee and distributed to the sales force from time to time. Accordingly, investors knew at the time of purchase what the additional credits would be, if paid. [Exhibits 226 at 47(a); 428; 735; 1548] In fact, the additional credits rate was filled in on the face of the contract application form.

Sample FIC and AIC contract application forms are found in Schedule "L".

ABC Plans

The ABC Plan ("Automatic Balanced Concept") was a combined accumulation mutual fund and accumulation certificate offered through FIC and AIC. [Exhibit 119] It was described by Mitchell in a memorandum to the sales force as follows:

> The ABC Plan epitomizes the balanced concept of investments. It offers diversification between guaranteed and equity investments. . . . [Exhibit 264 at 36]

Principal Savings & Trust Company Term Deposits

PS&T offered term deposits in any amount over $1,000 for terms of 1 to 10 years. Interest was fixed and was payable monthly, annually or could compound to maturity, at the option of the investor. [Exhibit 252 at 739] PS&T term deposits with terms of 5 years or less were insured by CDIC.

PS&T also offered services such as chequing and savings accounts and later a credit card.

PGL Promissory Notes

PGL offered for sale unsecured short term (1 day to 1 year) and medium term (1 year to 5 years) promissory notes. The denominations were multiples of $1,000, subject to a minimum investment of $100,000 (in 1981) or $50,000 (in 1985). These minimum amounts were in accordance with so-called "sophisticated investor" rules, whereby securities regulators did not require that a prospectus be filed or any registration depending on whether the purchaser was an individual or a corporation, the minimum prescribed amounts and the provincial jurisdiction in which the sale was made. Interest was paid on the notes at rates fixed by PGL at the time of issue. [Exhibits 187 and 54]

The purpose of PGL promissory notes was stated in 2 information memoranda entitled "Information Memorandum Short and Medium Term Promissory Notes" [Exhibits 187 and 54] as follows:

> The net proceeds from the sale of the Notes will be used for the general corporate purposes of the Company.

A sample PGL promissory note is shown in Schedule "L". [Exhibit 90 at 22-23]

Mutual Funds

A mutual fund was described by Blain in the *Insight* materials on the Mutual Fund Industry (1986) as a vehicle (a corporation, trust or partnership) in which money belonging to a number of investors is pooled for investment as a single portfolio, with the gains and losses shared by the participating investors. Participating investors may withdraw their proportionate share of the fund on demand.

The nature and features of the various mutual funds introduced by the Group, mentioned in Chapter III, are shown in Exhibit 186; I do not propose outlining them here.

The Investment Department of PGL, through PSML, was responsible for management of the mutual funds and their investment portfolios.

In 1983 or 1984 margin loans were allowed on mutual funds. Investors could borrow up to 50% of the value of their mutual funds. Most of the margin loans were made by FIC and AIC. [9021-2]

C. MANAGEMENT OF THE SALES FUNCTION

The sales function was managed at the most senior level by Donald Cormie as President of PGL, Marlin as the Executive Vice President, Sales of PGL and President of PCL, FIC and AIC and, to a lesser extent, by the Marketing Department of PGL and the Sales Committee of PGL.

Involvement of Donald Cormie

The evidence shows that Donald Cormie was involved in all aspects of the sales function.

Donald Cormie approved the budgets of the Sales and Marketing Departments of PGL. [16086-8; 16298-9] Donald Cormie testified that he would regularly become involved in PCL management decisions because PCL was consistently over budget each month. [15968-9; 16285; 20272-7; Exhibit 264 at 20 and 370] Donald Cormie was also personally involved in: approving interest rates to be paid on maturing certificates and term deposits if they were renewed; approving special advances to the sales force; approving changes in commissions and overrides; approving margin rates for demand loans; approving advertising overrides; approving the budget for and the contents of the PGL Annual Reports and 1985 Annual Review; and monitoring the salesmen's use of the computer and customer accounts to determine if they were stealing customer lists. [11765-6; 15976-82; 16319-20; 16446-7; 16075; 16435; 16071; 16649-50; 18470; 18572-3; Exhibits 264 at 380 and 431 at 26]

Donald Cormie also chaired the Sales Committee, which met weekly to review sales activity. The Sales Committee reviewed the sales performance of products and individual salesmen and set the interest rates for each product. According to Moulton, Donald Cormie made the final decisions at these meetings; decisions were not taken by majority vote. [4540]

Donald Cormie chaired the first part of the monthly Area Managers' meetings. [19616] He made instructional and motivational videotapes and speeches for the sales force and PCL sales management. [22124; 22332; Exhibit 502]

Occasionally, Donald Cormie instructed Marlin [15958-60] and other sales management, including Moulton [4529], Wallace [16153; 21271], Noble [21257-8] and Mitchell [16059] with respect to the administration and management of their areas of responsibility. Internal memoranda show Donald Cormie's involvement with product descriptions and information used to sell PGL promissory notes [16754], discussions with respect to ongoing sale problems [16363] and wording on monthly additional credit term certificates. [16333-5] He was involved in the initial development and design of FIC and AIC single pay certificates. [20066] He developed and ran a $1,500,000 mutual fund advertising campaign (called the "20/20 campaign") prior to Ritchie's arrival in the Marketing Department in 1986. [20258] He had to approve the opening of new PCL offices. [4530-1]

The evidence shows that Donald Cormie participated in the marketing of Group products and that his name and reputation were premier marketing tools of the Group. He gave public seminars on investing. He was interviewed by the print media and his skills in investing were reported in newspapers, magazines and books. The "Money Manager", a monthly newsletter produced by the Marketing Department and sent to customers, contained articles authored by him. [21502; Exhibit 45] The PGL Annual Reports and 1985 Annual Review which were used to sell the Group and its products were introduced by his Chairman's Message. [Exhibit 186]

An illustration of the use of Donald Cormie's name and reputation to market the Group is contained in the 1987 Reference Manual, which was intended for the use of the sales force but then recalled. It stated in part:

> Mr. Cormie is an innovative executive, known for having the vision required to be in the right place at the right time. In 1974, when the stock market was at an historic low, Mr. Cormie was buying stocks rather than selling. This strategy paid off in 1975 and 1976, when the stock markets soared. In the late 1970's, when Western Canada's real estate market peaked, Mr. Cormie sold off substantial property holdings. This judgment proved correct, as real estate prices fell in 1982 and 1983.
>
> Mr. Cormie's investment decisions are based on a unique long-term philosophy. Rather than using short-term, month-to-month fluctuations as a basis for investment decisions, Mr. Cormie relies instead on a thorough analysis of historical, long-term economic trends and patterns.
>
> Using an initial $60,000 investment as an operating foundation, Mr. Cormie has developed the business philosophy and provided the vision to make Principal Group the $1 billion financial institution it is today.

• • • • •

> Mr. Cormie is one of Canada's most prominent businessmen and has been profiled in numerous books and magazine articles. In one of these books: "The Money Rustlers: Self-Made Millionaires of the New West" the authors note:
>
> > "Cormie has always been the unquestioned leader of the umbrella Principal Group, but Ken Marlin is its boisterous heart." [Exhibit 93]

At Donald Cormie's direction, EL&F received "management fees" from PGL ($30,000 per month for a total of $360,000 in 1986). [7793] PGL received part of the distribution fee or override from the sale of each FIC and AIC certificate and these monies indirectly funded the payments to EL&F. As set out elsewhere in this Report, the evidence tends to show that Donald Cormie benefited directly from these payments to EL&F and thus had a direct pecuniary interest in maximizing FIC and AIC certificate sales.

Kenneth Marlin

Marlin was head of the "Money-In" function. His involvement in sales began in 1954. He was largely responsible for the development and training of the sales force. All sales personnel ultimately reported to Marlin as President of PCL and Executive Vice President, Sales of PGL.

In the early years of FIC and AIC, Marlin was directly involved in training the sales force to sell. By the 1980s he was no longer involved in training at the branch or division level, but was still involved in the instruction and motivation of the sales force through videotapes, speeches and memoranda. He also supervised the people who prepared materials for the sales force and reviewed manuals and made corrections where he spotted errors. [13604-6].

The evidence shows that Marlin never gave up responsibility for the sales force despite his other responsibilities, which included the development of PNI and dealing with the regulators on behalf of FIC and AIC. [12468] He continued to attend the Area Vice Presidents' and Area Managers' monthly meetings and take an active role in the Sales Committee.

Marketing Department

The Marketing Department performed the marketing function for all the Group's products. [5041]

During the late 1970s and early 1980s, John Hickey was Vice President, Marketing of PGL. After he left in late 1983, the position was not filled for some 2½ years. During that time marketing functions were performed by Mitchell and John Cormie, and occasionally Donald Cormie. [8967-8; 2470] In 1984 the Marketing Department was restructured under Marie Ulrich as Marketing Manager. She reported to Marlin. Ulrich was responsible for providing product descriptions and other materials for use by the sales force. [4546-7; 5039; 11662-3]

The Marketing Department was responsible for ensuring that FIC and AIC contract application forms and promotional materials were approved by the regulators in accordance with ss. 24, 25 and 46 of the *ICA*. Those sections are set out in Chapter VIII Part B of the Report.

John Ritchie assumed the position of Vice President, Marketing on July 1, 1986. [5037-8] The objective set for Ritchie by Donald Cormie at that time was to increase the volume of sales from $4 million to $7 million a week with a 4:1 ratio of mutual funds to fixed income products. [5039-40] Fixed income products included FIC and AIC certificates, PS&T term deposits and PGL promissory notes. The corporate objective for 1987 was $350 million in total volume; $250 million in mutual funds (including accumulation mutual funds and ABCs) and $100 million in fixed income products ($65 million in FIC and AIC certificates, $32 million in PGL notes and $3 million in PS&T term deposits). [5089; Exhibit 255 at 103-4]

Ritchie testified that he and Moulton strived to increase the size of the sales force in order to attain these objectives. [5050-1] From July 1, 1986 until the demise of FIC and AIC, the sales force increased from approximately 240 to 420 salesmen. [5056]

The Marketing Department was also responsible for surveying each week the interest rates being offered by competing financial institutions. These were presented at the weekly Sales Committee meetings. [5047] The competing financial institutions surveyed were all banks or trust companies. [Exhibit 239]

Sales Committee

The Sales Committee was chaired by Donald Cormie. The other long-standing members were Marlin, James Cormie and John Cormie. At various times during their tenure with the Group Petracca, Moulton, Mitchell, George Aboussafy (PS&T General Manager), Ulrich, Chris Wallace (Director of Branches), Wally Noble (General Sales Manager), Diane Cox (Public Relations) and Terry Pejnovic (Executive Assistant to Marlin) were also members of the Sales Committee. [4540-2]

The Sales Committee met weekly to review sales activity for the week and year to date. Sales reports and "Money-In" analyses reflecting volume of sales, sales according to product, and the performance of individual salesmen, branches, divisions and areas were reviewed. [4845; Exhibit 252 at 38 and 360] The Sales Committee also monitored and coordinated activities of the various departments involved in the "Money-In" function. [11648]

Interest rates for the "fixed income" products were set at these meetings. [4350; 5772] Should the committee members be unable to reach a consensus, Donald Cormie would set the interest rates as he deemed appropriate. [21080] Invariably, the rates for FIC and AIC certificates would be ¼ to ½% higher than the rates set for PS&T term deposits [2551; 5358-9], and were usually slightly higher than the interest rates offered by competing financial institutions. The rates for PGL promissory notes were usually higher than for FIC and AIC certificates. [5897] Rate sheets were then produced and provided to the sales force setting out the various interest rates offered on FIC, AIC, PS&T and PGL products and stating which of FIC or AIC was to receive all new money. [Exhibit 183; Exhibit 226 at 47(a)] A sample rate sheet which was effective May 22, 1987 is appended hereto as Schedule "J". [Exhibit 227 at 15-6]

The Sales Committee also discussed marketing plans, advertising campaigns and promotions, recruiting, expansion of the sales force and proposals with respect to opening new branches. [3752; 3977; 5772; 9111-2; 10953; 11646; 15042]

The Role of PGL

PGL provided administrative and investment services to FIC and AIC pursuant to service agreements. The terms and effect of those agreements are discussed elsewhere in this Report.

Through functional management PGL dictated budgets and objectives for PCL, its wholly-owned subsidiary, controlled sales and sales practices and provided marketing services. PGL was the general disbursing agent for all the members of the Group, for which it would earn income. [16522] The payroll was handled by PGL; paycheques were issued for all officers and employees, including commissions for PCL salesmen, with the expense being allocated to the appropriate company. [17861-6; 18510-13; 19268]

The Role of PS&T

PS&T acted as processing agent on the sale of all products. PS&T trust officers would handle the forms, enter the data relating to the sale into the computer system and arrange for the deposit of the funds. PS&T also provided the customer relations service for the Group. In return for providing these services PS&T earned brokerage fees on a per transaction basis. [3793-6]

The evidence tends to show that many investors in FIC and AIC products were told to make their cheques payable to "Principal Plans" [1142; 1345] or "Principal Savings and Trust" [193; 722] or "Principal". [1459] Cheques for PS&T term deposits were also made payable to "Principal Plans". [9060] Those cheques were cleared through PS&T through a nominee account called "Principal Plans", and then forwarded to the Royal Bank and distributed or allocated by PS&T to the particular company in whose products the investments were made. [3640]

The evidence also tends to show that the interest payable on FIC and AIC certificates was deposited into PS&T accounts which were automatically opened for investors at the time of purchase. [314; 320-1; 430-1; 742-3]

D. SALES OBJECTIVES AND STRATEGIES OVER TIME

Shift from Accumulation Plans to Single Pay Certificates

Marlin's evidence is that in the 1960s, 95% of FIC's and AIC's sales were accumulation plans and 5% single pay certificates. [11581] In the early 1970s, as interest rates started to move up, sales of single pay or term certificates became more significant. In January, 1978 the marketing strategy of FIC and AIC was redirected to the sale of single pay certificates. The stated objective of the strategy, according to the 1982 PGL Annual Report, was to provide a greater number of investors with an opportunity to obtain above average returns in high yielding certificates and high performance investment funds and generate "a dramatic increase in cash sales" that would allow the Group to meet the objective of $1 billion in assets under administration by 1984. [Exhibit 186]

As a result of the strategy, by the end of the 1970s the sale of single pay or term certificates comprised virtually 100% of FIC and AIC certificate sales. [11581]

Gordon Barefoot, an expert called by my counsel and a partner in Woods Gordon, prepared an analysis of FIC certificate liabilities showing the mix between accumulation plans and single pay certificates for the years 1973 through 1986. [Exhibit 606 at Schedule 10] It is appended hereto as Schedule "E". It shows that in 1973 accumulation plans accounted for 61.6% of the business by dollar volume and single pay certificates accounted for 38.4%. By 1986 accumulation plans comprised 5.5% of the dollar volume and single pay certificates 94.5%. Barefoot testified that FIC and AIC moved away from accumulation certificates to single pay certificates in "a dramatic way", resulting in a fundamental change in the way the business operated. They came to be very aggressive about increasing term or single pay products. [35612]

Barefoot testified that when interest rates rose in 1978 investors began to shop for rates and tended to look more to short term products rather than longer term accumulation certificates. In addition, changes in the tax structure in 1981, which became effective in 1982, made accumulations of interest reportable and taxable. Longer term accumulation products thereby became less advantageous and thus less attractive. [35614]

Barefoot prepared an analysis of certificate liability maturities as at December 31, 1977, 1979, 1985 and 1986. [Exhibit 606 at Schedule 11] The percentage of certificates maturing in under 3 years rose from 37% in 1977 to 83% in 1986. Similarly, the percentage maturing in over 3 years declined from 63% in 1977 to 17% in 1986.

Barefoot prepared similar analyses for AIC. [Exhibit 607]

Shift from "Guaranteed" Products to Mutual Funds

On May 14, 1984 Donald Cormie sent a memorandum to everyone in the Group entitled "Changes in the Organization and Changes in Management Strategy". [Exhibit 264 at 229] It stated in part as follows:

> 1. Management Strategy
>
> The emphasis of the Group will be increasingly shifted towards the sale of mutual funds rather than guaranteed products until such time as we have a ratio of $4.00 of mutual funds for every $1.00 of guaranteed product sales.

That was followed by a letter from Marlin to the sales force dated July 20, 1984 advising that the stock market was bottoming out and it was time to begin aggressively promoting the mutual funds. [Exhibit 264 at 368] The emphasis on the sale of mutual funds was coupled with a change in the commission structure to make their sale more lucrative for the sales force and the sale of FIC and AIC products less attractive. That change is described below.

The evidence tends to shows that the proposed shift away from FIC and AIC term certificates and PS&T term deposits was prompted by their low profitability. This was recognized in a study entitled "Principal Group Ltd. Customer Analysis" prepared by Rick Mathes in 1984, which concluded that the least profitable of the Group's products were term certificates, followed by term deposits. [Exhibit 264 at 178]

This low profitability was referenced in a document entitled "New Directions for PCL" which formed part of "The Package", a document distributed to the sales force in 1985 to introduce, *inter alia*, changes in the commission structure. It stated in part:

> This is a time of transition in financial markets. Transition from a time of inflation to a time of deflation. And perhaps most importantly, transition from fixed return and interest bearing vehicles to equity investment vehicles [mutual funds].
>
> These changes are having an impact on the way that Principal has to do business:
>
> 1. It is becoming extremely difficult to achieve a spread on term certificate and term deposit money. Due to the interest rate curve, changes in the wholesale and retail costs of money are far too close to make this a very profitable kind of business.
> 2. We are entering a phase of rapid equity market rise. In addition, closed and mutual funds will become vehicles appropriate to the kind of environment which we are facing over the next five or six years.
>
> The obvious conclusion to these observations is that we have to approach our business a little differently. Equity funds have to be given an even greater emphasis than they have had for some years now. . . . [Exhibit 264 at 712]

Donald Cormie testified that one of the reasons for decreasing the commissions payable on FIC and AIC term certificates was to reduce sales of those products. [16278] In fact that did not happen. The evidence shows that except for a brief decline in August and September of 1985, the sales of FIC and AIC certificates increased throughout the 1980s. [Exhibits 550 and 551; Exhibit 567 at 1046; 27142-3] As will become apparent, the reason for the increase was the need to take new money in to offset operating losses due to non-income producing assets in the companies' portfolios.

Sale of PGL Promissory Notes

The evidence tends to show that the sale of PGL promissory notes began in or about 1976, as a result of the dissolution of the Hutterian Brethern Investment Trust, of which PS&T had been trustee. Initially, sale of the notes was to Hutterian Brethern only, however it expanded to other individuals and corporations. [11714-20; 6731]

In early 1985 Donald Cormie directed that sales of PGL notes be increased and that longer term notes be emphasized. [4583-4; 16739] In response, Moulton prepared a "Two Month Action Plan" designed to increase the number of salesmen selling PGL notes and increase the volume sold by each salesman. [4584; Exhibit 264 at 599] Efforts to increase PGL note sales continued into 1986. [Exhibit 264 at 973] For a two month period from January to March, 1986 there was a "special promotion" on PGL notes during which there was a 1.5% spread between PGL notes (1 to 5 years) and PS&T term deposits. [Exhibit 441 at 39] That was followed by another promotion in May and June, 1986. [Exhibit 441 at 40]

The uses to which PGL note money were put are discussed elsewhere in the Report.

E. SALES FORCE

Development and Structure of the Sales Force

The development of the sales force was described by Marlin, who began his career with FIC as salesman in 1954. [11560-1]

By April, 1955 Marlin had recruited 15 salesmen in Regina. In June, 1955 he moved to Calgary, opened an office and commenced recruiting salesmen. By the fall of 1956 the sales force had expanded to include 30 salesmen operating from 5 locations in southern Alberta. [11562-3]

At that time, Marlin moved to Edmonton and assumed the position of sales manager for FIC, which then had operations in Red Deer, Edmonton, Calgary, Saskatoon and Regina. In July, 1957 FIC expanded its operations to Vancouver. [11563]

By the fall of 1959, FIC had approximately 300 salesmen, 150 in Alberta and Saskatchewan and 150 in British Columbia. A decision was taken to expand FIC's operations into the United States. That was done through two new companies, Principal Investors Corporation, a "broker dealer", and Principal Certificate Series Inc., a certificate company. Offices opened in Seattle in the fall of 1959. [11563-5]

Operations continued to expand from 1959 through 1962, with offices opening in Halifax, St. John's, Sydney, Saint John, Fredericton, Oregon and Washington States and Denver, Colorado. Operations expanded further in 1962 with the acquisition of AIC. [11565-7]

By 1963, some 98% of the business of FIC and AIC consisted of accumulation certificates or "thrift" business. That product range was considered too narrow, and thought was given to distributing the products of others, for example, products of trust companies or mutual funds. [11569-70]

It was decided that such an expansion would not be wise if the sales force was to be maintained. It was decided instead to focus on the expansion of assets under management and shift the thrust of the Group from thrift business to financial services. Approximately a dozen offices in the U.S. and Canada were closed and the sales force was reduced in size from 350 to 170 people. [11569-70]

With the incorporation of PS&T, PLIC and CMF a program of developing other products began. From 1963 to 1968 the Group's energies were focused on incorporating companies; broadening the product range; training staff, in particular the sales force, with respect to handling a multi-line product range; and introducing computerization. [11570-2]

With the incorporation of PGL in 1966 the employees of FIC and AIC became employees of PGL. [11575-6]

In 1969 a decision was made not to expand the product line to include the life insurance business because of rising interest rates and a falling stock market.The money which had been earmarked for launching the life insurance company was invested in real estate. [11573-4]

PCL was incorporated in 1970. [Exhibit 186; 11592] Thereafter the sales force was managed through PCL, which essentially operated as the Sales Department of PGL.

By 1970 the Group's business was comprised of 80% mutual funds and 20% certificates. By the fall of 1974 there was a reversal of that mix; the Group was selling 80% certificates and 20% mutual funds. [11575]

In 1977 or 1978 a decision was made to introduce an on-line computer system. In the end the Group purchased a GEAC computer and wrote its own software program which allowed all the companies in the Group to be on the same system. [11579-80]

In 1979 there was a shift in the direction of the sales force in anticipation of a "bull market". The Group saw a "real opportunity for their clients by getting into mutual funds" and made a conscious decision to discontinue the thrift business and to concentrate on the "cash" business, that being the single pay business; to look for "investors as opposed to savers". [11579] That resulted in the shift to the sale of single pay certificates already mentioned.

Moving into the cash business, together with the development of an on-line computer system, lead to the development of the "Principal Financial Centre" ("PFC") in order to increase the efficiency of the sales force by bringing prospects into the office rather than going to their homes, which had hitherto been the case. The on-line system meant that there were no accounting functions taking place in the office, so PS&T and PCL could operate from the same location. The first PFC opened in Edmonton in 1979. [11580-1] PFCs were one-stop retail outlets offering not only the Group's products but also the financial services of PS&T (such as chequing and savings accounts).

In the early 1980s, when interest rates were high and short term rates were higher than long term rates, it was found that advertising short term rates and "edging" the market slightly (i.e. paying slightly higher rates) brought many clients into PFCs. When interest rates returned to normal, "that technique of advertising to attract clients was not near as effective" and it was found that the sales force had developed into "order takers" rather than salesmen. A decision was taken to restructure the sales force. The decision was motivated in part by the desire to eliminate "the problem of sales people, new sales people, moving into the financial centres and not learning to be salesmen, not learning to prospect." [11582-3] By 1986 the Group had as its objective expansion to 1500 salesmen over a 5 year period. [4821]

As part of the restructuring process in late 1985 and early 1986, the field sales manager concept was developed. This lead to what Marlin described as:

> Two separate sales forces, one of them being the field sales manager trainee division operation where new people would be trained without the benefit of existing clientele, without the responsibility for servicing existing clientele, and they would focus their time entirely on learning the product, learning time management, learning how to prospect.
>
> The other arm of the force worked out of the financial centre or out of branches as we called them. Some of them were financial centres, some of them weren't, but they were public offices. They assumed the responsibility of looking after the existing clientele and were responsible to the branch manager who looked after the business on the books . . . and also looked after the upgrading of the qualified sales people and account executives. [11583-4]

Moulton was directed by Marlin to implement the restructuring. He testified as follows:

> . . . We began the reorganization at the end of 1985 and through early 1986, and we found that the level of training improved dramatically as a result of this one-on-one training. We felt that this type of training differentiated our company from others in the industry. [4821]

The two arms of the sales force were called the Field Division and the Branch Division. The field organization and operation chart of the sales force and a typical regional organizational chart as at June 30, 1987 are shown in schedules "F" and "G" to this Report. [Exhibit 93]

The Regional Vice President was the head of both the Field Division and Branch Division within a region, and was appointed by Marlin on the recommendation of the Vice President, Field Operations. Regional Vice Presidents reported to Marlin but on a day-to-day basis were accountable to Moulton, the Vice President, Field Operations of PCL. [Exhibit 93]

General responsibilities of Regional Vice Presidents included managing the region, maximizing the volume of sales and attaining set sales volumes on a monthly basis. Specific responsibilities included supervising, motivating and assisting the Area Manager or Area Vice President, the Field Sales Manager and the Branch Manager in achieving their goals. It was recommended that 80% of the Regional Vice Presidents' time be spent on field visits. They prepared regional objectives and budgets with the assistance of the Area Manager or Area Vice President, and were responsible for keeping expenditures within the budgetary guidelines. [Exhibit 93]

The Area Manager or Area Vice President was appointed by Marlin on the recommendation of the Regional Vice President and the Vice President, Field Operations, and reported directly to the Regional Vice President. General responsibilities included recruiting and hiring personnel. It was recommended that a minimum of 60% of their time be spent on recruiting. The Area Manager or Area Vice President was also responsible for attaining monthly personnel, volume and budget objectives. Specific responsibilities included prospecting and opening new offices, with approval from the Regional Vice President and PCL head office, where personnel, volume and budgets warranted it. Implementation of the standardized training program was also their responsibility. They directly supervised all the Field Sales Managers and Branch Managers in the area. [Exhibit 93]

The Field Sales Manager was appointed by the Vice President, Field Operations on the joint recommendation of the Regional Vice President and the Area Manager or Area Vice President. The Field Sales Manager reported directly to the Area Manager or Area Vice President. The Field Sales Manager's general responsibilities included training, supervision and advancement of salesmen. In addition, they were required to attain personnel and volume objectives as established by the Area Manager or Area Vice President on a monthly basis. Specific responsibilities included accompanying new salesmen and assisting them in field presentations. It was recommended that a minimum of 60% of their time be spent on field presentations. They also instructed new salesmen on the fundamentals of thrift sales and demonstrated in the field the concept of "total sales": prospecting, preparing, present ing, closing and after sales follow-up. New salesmen were taught about products, policies and procedures by the Field Sales Manager, who was required to hold daily motivational sales meetings. It was the Field Sales Manager's responsibility to report to the Area Manager or Area Vice President on a daily basis and to PCL head office as required. Supervision of all sales trainees and levels 1 and 2 Financial Consultants (as described below) in the division was a responsibility of the Field Sales Manager. [Exhibit 93]

Branch Managers were appointed by the Vice President, Field Operations on the joint recommendation of the Regional Vice President and the Area Manager or Area Vice President. The Branch Manager reported directly to the Area Manager or Area Vice President. Branch Managers were appointed in those locations with established client bases. They were required to have excellent product knowledge, strong selling skills and strong leadership and people management skills. General responsibilities included maximizing the volume of sales in the Branch and attaining monthly objectives for sales volumes and business retention established by the Area Manager or Area Vice President. The Branch Manager was to hold daily sales meetings in order to motivate branch personnel and inform them of products, policies and procedures. They reported to the Area Manager or Area Vice President on a daily basis and to PCL head office as required. In order to lead by example, they were required to personally sell products. They were to supervise the Qualified Consultants and Account Executives (salesmen as described below) and any other support personnel that might be assigned to the branch. "Key Result Areas" for Branch Managers were sales volume, reporting, business maintenance, personal sales, education, compliance and customer relations. [Exhibit 93]

The management by objective philosophy pervaded middle management and lower levels of the sales force. Area Managers and Area Vice Presidents were required to set objectives for their particular areas, and met with senior PCL management, Marlin and Donald Cormie at monthly meetings to have their area sales activity evaluated. Salesmen were required to report on their sales activities (including volume of sales, number of presentations and number of telephone calls) daily at morning meetings chaired by their respective Branch Managers. Evaluation of the previous day's activity would take place and objectives for the day were set. The purpose of the morning meetings was threefold; to provide accountability, instruction and motivation to the sales force. [3608]

Status and Registration of Salesmen

Prior to commencing training, each recruit executed a Sales Representative's Agreement with PCL, FIC and AIC. Pursuant to this agreement salesmen were characterized as independent contractors appointed to canvass for applications for investment contracts and mutual funds. Remuneration was based solely on commission. [Exhibit 227 at 2; Exhibit 240 at 181; Exhibit 625 at 8] A sample Sales Representative's Agreement is appended hereto as Schedule "K".

After execution of the Sales Representative's Agreement, the salesman was referred to as a "Principal Consultant".

In order to comply with the requirements of the *ICA* for the sale of investment contracts, salesmen submitted applications for registration and were licenced as salesmen of FIC and AIC, since FIC and AIC, but not PCL, were registered as issuers under the *ICA*.

Salesmen were also licenced through the Investment Funds Institute of Canada ("IFIC") to sell mutual funds, upon successfully completing the IFIC examination. [37104-5] PCL was registered as a mutual fund dealer. [6634; 8766; 17763]

Qualifications for Selling

Salesmen could sell a variety of products depending upon their qualifications. The levels and qualifications of salesmen together with the products they were allowed to sell was summarized in a Commission Schedule effective December 31, 1986 [Exhibit 150] as follows:

Sales Representative Levels	Qualifications	Products The Sales Representative May Sell
Sales Trainee	- Not licensed to sell Investment Funds and Investment Contracts	Accounts, Services, Term Deposit and Canada Savings Bonds
Level 1 Financial Consultant (hereinafter called "Level 1")	- Licensed to sell Investment Funds and Investment Contracts - Career Volume below 100,000	All Products except PRINCIPAL GROUP LTD. Promissory Notes
Level 2 Financial Consultant (hereinafter called "Level 2")	- Licensed to sell Investment Funds and Investment Contracts - Career Volume below 500,000 but not less than 100,000	All Products except PRINCIPAL GROUP LTD. Promissory Notes
Qualified Financial Consultant (hereinafter called "Qualified")	- Licensed to sell Investment Funds and Investment Contracts - Career Volume of 500,000 and over	All Products

Sales Representative Levels	Qualifications	Products The Sales Representative May Sell
Account Executive	- Licensed to sell Investment Funds and Investment Contracts - Career Volume of 2,000,000 and over In the service of the Companies as a Sales Representative for at least 2 years - Attain 175 QPR Volume for three consecutive Sales Months - Maintain 110 3MMA Volume or 110 6 MMA Volume - Enrollment in, or graduate of, Chartered Financial Planners Program as recognized by the Companies	All Products

Sales performance was measured in terms of "Volume", which was the numerical value assigned to a product and credited to a salesman for its sale. [Exhibit 178 at 2] A salesman's career Volume would determine his level in the sales hierarchy.

Commissions and Overrides

The salesmen were paid commissions and middle management were paid commissions and overrides on the sale of the various products of the Group. The level of commission payable with respect to the sale of a particular product was dependent on the level of the salesman who sold it.

In addition to commissions, overrides were payable to Field Sales Managers, Area Managers and Branch Managers according to the productivity of the trainees or salesmen they supervised. Field Sales Managers were also paid development bonuses if their trainees achieved a certain level of volume within a certain period of time. [2781-2; 3476; 3530]

Corporate overrides were also paid upon the sale of products. They were amounts that were distributed to various companies within the Group based on levels of sales of products. This is discussed elsewhere in the Report.

The commission and override structure remained relatively consistent over the years, but for changes implemented in 1985. In July, 1985 mutual fund commissions increased. In October, 1985 FIC and AIC certificate commissions were decreased and those for PGL notes doubled. The changes may be summarized as follows:

1985 CHANGES IN COMMISSION STRUCTURE[1]

(Per $1000 Sale of Product)

	PS&T Term Deposit (1-5 year terms) Per Year	FIC/AIC Additional Credit (1-10 year terms) Per Year	PGL Promissory Notes (1-5 year terms) Per Year	Mutual Funds (unadjusted)[2]
BEFORE				
Level 1	$1.00	$2.00	N/A	unavailable
Level 2	$1.27	$2.55	N/A	unavailable
Qualified Consultant	$1.50	$3.00	$3.00	$30.00
Account Executive	$1.90	$3.68	$3.00	$36.80
AFTER				
Level 1	$1.00	$1.50	N/A	$22.78*
Level 2	$1.27	$1.90	N/A	$28.90*
Qualified Consultant	$1.50	$2.25	$6.00	$34.00*
Account Executive	$1.90	$2.52	$6.00	$40.10*

* Mutual Fund Bonus:

$16.00 Bonus paid approximately 3 years after sale if:

a) Consultant still employed by PCL; and
b) Client still had at least 10% of amount deposited in funds 3 years later.

1. Source Exhibits 213 and 218
2. Commissions on mutual funds were adjusted in accordance with the acquisition fee.

NOTE:

Further changes were subsequently made to the commission schedule. As at June 30, 1987 they were as set out in Exhibit 93.

With the increase in commissions on sales of mutual funds and PGL promissory notes and the decrease in commissions on term certificates, the middle management overrides increased or decreased respectively. [Exhibit 524 at 106]

On accumulation certificates and accumulation mutual funds, the salesmen would receive staggered commissions or "trail commissions" payable over a number of years pursuant to the PCL schedules in force. [Exhibits 120 and 150]

Given the commission structure, it was most lucrative to the sales force to sell mutual funds, followed by PGL notes, then FIC and AIC term certificates, and lastly PS&T term deposits. The evidence tends to show that commissions paid on various products influenced the quantum of products sold. [2020; 2457-8; 3953; 5092; 13461; 15180; 16278; 21355; 37191] In turn, the commissions reflected the sales objectives and strategies of the Group.

Training

The evidence tends to show that prior to about 1986 there was no standardized training program in existence. While there were a number of "basic manuals" (training manuals) which had been in use for 20 or 30 years, the training process varied from Area to Area and Branch to Branch. [4919]

The evidence tends to show that the emphasis in training was on sales technique. That was confirmed by Marlin as follows:

> Q MR. WITTMANN: Now, Mr. Marlin, you were involved with respect to training of the sales force, literally from inception, when you came to open the office in Calgary, is that right?
>
> A That is right. It started in Regina, really, but yes.

Q You have your own particular philosophy of sales and training salespeople, do you not?

A Yes, I suppose you could say that.

Q Could you tell us what it is?

A Number 1, you have to hire the right person and have to have a clear picture of the type of individual that can succeed in selling, who is willing to do what is required.

While we didn't have any formal testing or selection methods initially, we decided that we had to look for methods of identifying -- I used to call them "winners", someone who had a high level of energy, who wanted to have money, and was highly disciplined with ego and empathy. If you could find that individual, your chances of having a successful salesman were exceptionally good.

Once you've hired the salesman, I found the key was to put them through a course, a training course concentrating, first of all, on orientation, company orientation, so that he or she understood clearly what the mission of the company was, what it stood for, who was behind it, and why it was good for the world.

Q *In doing so, were you painting the picture that Don Cormie painted for you?*

A *That is exactly right, yes. Painting the big picture, if you like.* And if you couldn't paint or get the big picture accepted, that was the end of the training.

Q What did that involve, just briefly?

A *That would involve the use of what later on became the Annual Report, or the Annual Reviews. That was an important part of company orientation that helped to paint the big picture.* That was done in the office, in discussions, in most cases, with a group. We found training much better to have at least three to six people at a training session. However, where that was not possible, sometimes it was a one-on-one type of training.

The second priority that we aimed at was product orientation to emphasize what services we made available to the public and how those services, again, made a contribution to society and to the community and to the individual. We found it very important for the potential salesman to believe in the philosophy.

In the early stages many of our salespeople attributed their success not to the product, not to the interest rate, but to the fact that they, themselves, had applied the philosophy, were living what they were preaching. *They believe in thrift and they were on a crusade. And they actually did attribute their success to that crusade, as opposed to anything the product might have in terms of terms and conditions or interest rates or clauses and conditions.* So that was considered a very important part.

The third emphasis was keeping the product range narrow and learning a verbatim sales presentation so that the proper words were used, the proper explanations were used, the best possible motivating phrases were used in the presentation. We literally trained them to be professional enough in learning their lines that they would give a verbatim presentation before they graduated.

Q That is called scripting, right?

A That is *scripting*, yes, *roleplaying*. It was very useful in that we knew what the salesman was saying. If he used a scratch paper to illustrate, that went in the file and was saved. You would go back a year later and say, I saw so and so, here is the paper I used to explain it, and it was there. That was standard across the country.

> We found that very useful in supervision. I used to personally, up until the mid-70's, work in the field with new people as I travelled across the country. We had several hundred sales people, but I found that I could do more to help the local manager by spending a day in the field with a new salesman, than I could meeting with the manager in the office because I could tell the quality of the training, I could tell what the morale was, I could see if the system was working.
>
> It was quite interesting, because *I go through some of the sales material today, and I see those same phrases from 30 years ago still being used. We found that was very valuable in controlling how things were explained*. And only once they had mastered that could they move on to learn the next step.
>
> The fourth point in the training was time management or, what do you do all day. It was trained in the field. That is where the new sales representative worked the buddy system, if you like, hands on, all day, to get the standard of activity high enough, to get the standard of planning high enough, get the card system set up, the prospecting methods working. We found that once we could get them with the right presentation and working the right pattern, their success was literally assured. [11609-13] [Emphasis added]

The evidence tends to show that less time was spent on training the salesmen with respect to the characteristics of the products sold by the Group. Prior to the effort to introduce a standarized training program, there were no written examinations to test the product knowledge of the salesmen with respect to FIC and AIC certificates. [2771] A Field Sales Manager responsible for training new salesmen and supervising salesmen at Levels 1 and 2 testified as follows with respect to the training he gave sales trainees:

> Q Could you focus a little more on the safety of the investment, the things that, I believe, you've heard other witnesses talk about, the Investment Contracts Act, the assets on deposit, the qualified assets, the difference between the term certificate, FIC/AIC and a term deposit. How did you train people about those things?
>
> A We would train them -- first off, we'd go through a rate sheet, show them the three different columns, Principal Savings and Trust, explain what Canada Deposit Insurance Corporation was, what it covered, what it provided, up to $60,000 less than five years' maturity.
>
> We'd explain the Investment Contracts Act and what that Act included, specifically, the -- that those companies had to have assets equal to their liabilities on deposit with a government-approved custodian.
>
> Q Would you train the rookies that the bank was the Royal Bank of Canada?
>
> A Not specifically.
>
> Q *Would you give them a copy of the Investment Contracts Act?*
>
> A *No.*
>
> Q Would you tell them that there were regular reporting requirements?
>
> A Yes.
>
> Q *Would you tell them what qualified as assets under the Canadian and British Insurance Companies Act?*
>
> A *No.*
>
> Q *In terms of financial information about FIC and AIC, would you give them any detailed financial information?*
>
> A *No. I had none.*

Q Would they ask questions?

THE INSPECTOR:

You say you had none?

A I had none.

Q MR. WITTMANN: Would they ask questions, sir?

A Generally not. [2773-4] [Emphasis added]

Other salesmen testified that they were given no specific financial information about FIC and AIC. [2437; 2719; 2774; 3470-1]

In November, 1986 discussions began concerning the implementation of a "standardized training program". Moulton testified that "over the past 30 years, there were a number of training programs that had been developed, and this was an effort to implement the training program that really had been developed within the Northlands Area in Edmonton, during early 1986 and previously". [4703] Steps were taken to "identify the type of material, consolidate it into a training manual, and then introduce the material in a variety of forms across the country, and then follow up on its implementation". [4704] Moulton testified that:

> . . .The standardized training program, which was really developed from the Northlands' training system that Louis Gratton and his managers had worked on, emphasized the simplicity of training, that is, to make sure that you had good training. It was important that the new trainees not receive the complete product line and that the emphasis was primarily on selling Thrift and Accumulation plans. So, we adopted that standardized training program and, as was entered in evidence last week, we began extending this across the country in the fall of 1986. The standardized training manual was again an important attempt to ensure that the training was standardized throughout the company. And the training manual itself took some time to prepare, and it was in a number of different formats but, ultimately, was distributed to the field sometime in 1987. [4823]

The standardized manual Moulton referred to was the 1987 Reference Manual dated February, 1987 [Exhibit 93] which was partially distributed then recalled. [3336-7] The reason for the recall is not clear from the evidence. There was some evidence that it was because of "sensitive material" in it [3337], other evidence that it was because some of the material was out of date [3521], and still other evidence that it was because of concern about a cash deposit the sales force were being asked to pay for it. [2805; 2852]

The standardized recruitment and training program in effect in the Northlands Area appeared to be the most comprehensive of any. There prospective recruits were screened by use of a personality test (the Merritt Personnafax) which "helps determine the predictability of success in the financial sales field". [3321-3] Following their recruitment as sales trainees, salesmen were required to write the IFIC examination. [3326-8; 3335; 3381] Thereafter, they began their training as follows:

GRADE 1

Length of time	— 4 weeks in the field
Classroom Instruction	— 4 days
Content	— Introduction of basic sales skills and the mastery of the thrift presentation
Standard	— Successful and professional thrift presentation — Acceptable work activity — 90% passing grade on Grade 1 Exam — 30 days and 12 accumulation plan sales

GRADE 2	
Length of time	— 4 weeks in the field
Classroom Instruction	— 4 mornings — 8:30 a.m. to 12:00 p.m.
Content	— Lee Dubois course in selling techniques
Standard	— Successful oral thrift presentation using L.C.D. techniques
	— 30 days and 12 accumulation plan sales
GRADE 3	
Length of time	— 4 weeks in the field
Classroom Instruction	— 2 mornings - 8:30 a.m. to 12:00 p.m.
Content	— Single pay mutual funds, Fixed term products, Portfolio Presentation
Standard	— 75% passing grade on Grade 3 written exam
	— 30 days and 12 accumulation plan sales and/or single pay mutual fund sales
GRADE 4	
Length of time	— 4 weeks in the field
Classroom Instruction	— 2 mornings — 8:30 a.m. to 12:00 p.m.
Content	— 90% passing grade on written product exam
	— Successful oral presentation of ABC 2 balanced sales [Exhibit 237 at 59]

F. PROFILE OF THE INVESTORS IN FIC AND AIC

In 1984 PGL prepared a document entitled "Customer Analysis" which reported on, *inter alia*, client demographics. [Exhibit 264 at 178] In 1986 it was partially updated. [Exhibit 255 at 2] The latter document reported as follows:

> ### I. CUSTOMER DEMOGRAPHICS
>
> Much of the information here is based on our March, 1984 customer study. Due to the GEAC 9000 computer conversion currently in progress, most of the March, 1984 information could not be updated.
>
> #### A. Age and Sex
>
> The average Principal client (weighted by $ invested) is 51 years old. 61% of Principal clients are male. Mutual funds appeal most strongly to the 25-54 age group and somewhat more strongly to males than to females. The over 55 group is less interested in mutual funds and more interested in term certificates.
>
> Clients joining in 1985 and 1986 fit the same profile as existing clients.

TABLE 1
CLIENTS BY AGE & SEX
(As at March 31, 1984)

	Under 25	25-34	35-44	44-54	55 and Over
Female					
Number Active . . .	1,262	5,334	5,126	4,824	7,554
Total Deposits	$4,580,000	$25,940,000	$38,580,000	$52,790,000	$122,610,000
Average Deposit . .	$3,630	$4,860	$7,530	$10,940	$16,230
% Funds	24	33	34	34	26
% Cheq/Savings	13	9	8	6	6
% Terms	60	55	54	56	64
% Loans	3	3	4	4	4
Male					
Number Active . . .	1,343	6,300	6,579	5,774	9,809
Total Deposits	$7,340,000	$36,860,000	$62,860,000	$79,270,000	$194,730,000
Average Deposit . .	$5,740	$5,850	$9,550	$13,800	$19,850
% Funds	33	46	43	40	31
% Cheq/Savings . .	18	11	12	10	7
% Terms	44	37	39	46	57
% Loans	5	6	6	4	5

Notes:

1. Doesn't include joint accounts.
3. Doesn't include clients with missing age codes.
3. Overall average age is 51 (weighted by deposits).
4. Doesn't include accumulation certificates, mortgages or GRSPs.

• • • • •

B. Customer Income Levels

In the questionnaire mailed to our clients, 41% of client [sic] reported earnings of less than $25,000 per year. 88% made less than $50,000. Clients making over $25,000 were more likely to own an RRSP and to have loans against their funds. Clients in the $25,000 — $49,000 range are somewhat more likely to own funds than the other groups.

Despite the moderate income levels of our clients, most of our deposits are held by clients with over $20,000 invested. This is perhaps a reflection of the relatively high average age of our clientele.

• • • • •

C. Customer Location

In the survey, 75% of clients reported that they lived in Alberta or B.C. 97% live in either Alberta, B.C., Saskatchewan, or the Maritimes.

II. CLIENT PURCHASING PATTERNS

A. Products Purchased

As of March 1986 there were 81,650 active clients. The breakdown of these clients by product owned is as follows:

TABLE 4
PRODUCTS OWNED BY CLIENTS

Savings only*	3,747
Chequing only*	2,127
Term only	18,129
Fund only	25,070
Accumulation certificate (includes ABC)	14,256
Other products (mortgage, GRSP, RHOSP)	3,946
Savings/chequing *and* term	3,239
Savings/chequing *and* fund	1,284
Fund *and* term	7,762
Savings/chequing *and fund* and *term*	2,090
Total	81,650

* "Savings" includes regular savings only.
"Chequing" includes TMS, Platinum Plus and Classic Chequing.

B. Term Reinvestment

Approximately 60% of maturing term certificate money is reinvested into term certificates. About 5% is invested into funds. The reinvestment ratio for maturing RRSP terms is very high (100%) reflecting both lower liquidity and additional contributions at the time of reinvestment. Interestingly, 90 and 180 day terms have similar reinvestment ratios to terms 1 year and over. The shorter duration of these terms seems to be balanced off by increased liquidity needs.

C. Cross-Selling

As shown in (D) [sic] above, only about 17% of our clients have active accounts in two or more different kinds of products. On the most basic "cross-sell", getting the client to buy both terms and funds, it is interesting to note that while 25,070 clients own funds only, and 18,129 own terms only, only 9,852 own both terms and funds.

D. Clients' Wants/Needs/Interests

In the survey, clients stated that the feature most important to them was interest rates, followed (in order) by low risk or stability, performance (i.e. funds), tax benefits, "growth", personal service, and corporate credibility. Clients who owned savings/chequing accounts, RRSPs, and terms were very strong in stating interest rates as the most important factor. Fund clients cited tax benefits, growth and long-term performance as more important than interest rates. Term clients felt that short-term performance was more important than long-term performance, while fund clients felt very strongly that long-term performance was more important.

Clients had found out about Principal through a variety of means, including from consultants (29%), newspapers (26%), friends (25%), and "other" (23%). "Other" includes media other than newspapers and radio, and walk-in business.

Nearly all of our clients deal with at least one other financial institution. Most commonly this institution is a bank (81% of clients), and the most common reason given for doing business there is "convenient location" (16% of clients).

The large majority of clients (68%), consult newspapers for information about banking and investments. Only 15% consult magazines, the second most popular source of information.

The evidence of those investors in FIC and AIC products who testified at the hearings tends to show that while they were not adverse to a good rate of return, their first priority was a safe, secure investment. They were savers, not speculators.

This was confirmed by Marlin, who testified as follows:

> Q Again, then, sir, in summary, in talking about this area, when we are talking about people purchasing these contracts or these contract holders, these were people who didn't play the horses or the mutual funds. As far as your profiles indicated they were savers, weren't they?
>
> A Yes, they were savers. They were people who had not been involved in investments that had equity base or there was a risk in. [13311]

The evidence tends to show that investors were particularly anxious to put their money into safe and secure investments after the deterioration in the economy in the early 1980s and the problems encountered by some financial institutions. As one salesman testified:

> In 1982, '83 we had a lot of clients coming in very concerned about the safety of their investment and wanting to maximize their interest rates, and they had a tremendous concern about safety. [37096]

G. INTERNAL AUDIT

In approximately 1985, in an effort to emphasize the importance of the sales force properly explaining the nature of the Group's products and their risk and security to investors, the Internal Audit Department of PGL set up a program described to the sales force as follows:

> The Internal Audit Department is setting up a process of confirming with an on-going sampling of clients, the nature of their understanding concerning the above points. This is intended to be a means of ensuring that we are doing the best job possible for our clients. If Internal Audit discovers apparent misunderstandings by clients, then we will follow up to confirm the facts and to ensure the consultant in question is on track. [Exhibit 250 at 107]

"Client transaction verification questionnaires" were developed for the various products of the Group. [Exhibit 250 at 162] With respect to FIC and AIC certificates, the questionnaires tested the investor's awareness of the *ICA*, CDIC insurance coverage and additional credits.

The results of the questionnaires revealed a lack of understanding by investors in all 3 areas. [4412] According to Noble, "approximately a third of the clients were confused." [4414] He testified that:

> . . . when it comes back on an internal audit report that there's a 30% or thereabouts confusion about the Investment Contracts Act, or whatever, it wasn't necessarily alarming. It was, maybe not par for the course, but it's logical that there would be misunderstandings on it. So -- so I think that's the first thing that, in reading it, we would have understood that there would have been misunderstandings. So it's something that we already had known, and this verified the percentage, I guess. [4413-4]

One of the surveys revealed that 41% of the respondents were not aware that FIC and AIC term certificates were not covered by CDIC. [13619; Exhibit 253 at 258-68] Marlin testified that he did not accept that statistic. He was of the view that the respondents did not understand the nature of CDIC rather than whether their investments were covered. [13620-1] John Cormie's reaction was that "there was something wrong with the survey". [9069] Moulton had concerns about the questions that were asked and disputed the accuracy of the replies. [4711; 4897- 8]

It appears that little, if anything, was done in response to the surveys. As at March 31, 1987 responses to the questionnaire indicated that 31% of investors contacted still did not fully understand CDIC coverage or if it was applicable to the products they had purchased. [Exhibit 431 at 134; 2775-6] A memorandum was sent out to middle management in the field on June 5, 1987 clarifying that CDIC applied only to PS&T term deposits. [Exhibit 431 at 134]

These 3 areas identified by Internal Audit, together with others, are discussed below.

H. REGULATORY APPROVAL OF SALES MATERIALS

Reference has already been made to ss. 24, 25 and 46 of the *ICA*. The ICA prohibits any document to be used in connection with the sale of an investment contract unless it had been approved by the Superintendent of Insurance. No representation was to be made that the regulators had in any way passed on the financial standing or solvency of FIC or AIC or on the merit of any of their investment contracts.

Although Marlin testified that "any material that was used in selling or any advertising was to have prior approval" [11698], the evidence shows that apart from several brochures specific to FIC and AIC term certificates [Exhibits 112 and 113], the contract application forms [Exhibits 100 and 403] and certain newspaper advertisements [Exhibit 403], the materials used in connection with the sale of FIC and AIC products were not submitted to or approved by the Superintendent. Marlin admitted that although the Annual Reports were distributed to the public they were not submitted for approval. [11699]. Other materials not submitted or approved included the 1985 Annual Review, the Risk-Return Tradeoff Chart, the grid chart, the Principal Story, the "Richest Man in Babylon" booklets, various product information materials, the sales presentation materials, various other Principal brochures and newspaper and magazine articles. Most of this material related to "Principal" rather than FIC and AIC and was used to sell the Group and its benefits, after which particular products were pitched.

Further, as will be seen below, many of these materials contained representations with respect to the safety or security of FIC and AIC certificates in the context of "government protections" under the *ICA* or otherwise.

The evidence tends to show that the failure to submit promotional materials for approval and representations in many of the materials to the effect that investment in FIC and AIC was afforded government protections were deliberate breaches of the *ICA* on the part of Marlin.

I. SALES TECHNIQUES AND REPRESENTATIONS

The Selling of Principal Group

The primary sales strategy used by the Group, and used extremely effectively, was that of "selling Principal". Donald Cormie testified that the aim was to forge an overall identification with the Principal Group. [20246-7] The selling of "Principal" took many forms, ranging from the introduction and selling of the Principal Group by recruiters to potential salesmen to the selling of Principal products by a Principal financial consultant in a PFC using Principal promotional materials.

The purpose of selling Principal Group was to attract purchasers of Principal products by selling the financial strengths and diversification of the Group. The Group was sold first, then particular products. The concept of a balanced or diversified portfolio was emphasized. Such a portfolio necessitated the purchase of both thrift products and mutual funds offered through the Group. The fact that in many instances in purchasing thrift products an investor was contracting with either FIC or AIC was not emphasized. Indeed, as will be seen below, some investors did not realize they had contracted with FIC or AIC.

The selling of Principal Group began with the recruitment of salesmen. Advertisements for "financial consultants" made no mention of PCL, FIC or AIC, but rather referred to openings "with the Principal Group", the "leading developer of financial planning services". [Exhibit 237 at 28] The recruiting package included memoranda stating that "Principal people are carefully chosen" and "your future is with Principal". [3323; Exhibits 211 and 167] The Annual Reports and the 1985 Annual Review, which refer to PGL and the Group, were also used in both recruiting and training. [2784-6; 11610; 12548; 37067-8; 37079-81] Individuals were shown a videotape entitled "This is Principal" to introduce them to the Group [5044] and received a welcoming letter from Donald Cormie or Marlin which read in part:

> Ours is a young, vigorous and growing company. Each year we have experienced a considerable increase in volume of business. Our operations have expanded rapidly, and this has meant exceptional opportunities for all our Principal Group personnel. [Exhibit 248 at 1]

Once "sold on Principal Group", a recruit was taught how to sell the Group to the customer or "prospect". Each trainee had to learn a verbatim sales presentation which introduced "Principal" and the Principal concepts, being thrift and diversification or the balanced portfolio. [3329-30; 11610-11; 11618; 11625-6; Exhibit 151]

The "Principal Presentation" another instructional aid, instructed salesmen to:

> Introduce the company using the Annual Report or the Principal Story brochure. State some of the major *facts* about the Company and the *benefits* this provides the Prospect. . . . [Exhibit 248 at 70] (emphasis in original)

The "Company" referred to is the Principal Group of Companies.

The Slide Presentation [Exhibit 122] introduced the people from "Principal Group" and provided background information on the "Principal Group". PCL, FIC and AIC were not mentioned. Similarly, the Presentation Manual [Exhibit 138] emphasized the strength of "Principal Group" and stated that it was managing $1.2 billion in assets. This latter claim is discussed later in this Report.

Sales trainees were instructed to "learn a sales formula based on the company concept" and were told to "sell the company, sell the dream". [Exhibit 248 at 143]

The evidence shows that the selling of Principal continued to be a major theme subsequent to the initial training of the salesmen. A summary of a talk given by Donald Cormie on March 6, 1987 circulated to Regional Vice Presidents, Area Managers and Area Vice Presidents advised:

> Do not get overly attached to the product, but to the company and its concept. [Exhibit 248 at 156]

In a talk by Marlin on the same date, he advised those same individuals to get the salesmen to sell "the concept", that being thrift and a balanced portfolio. [Exhibit 248 at 157]

In dealing with a prospect, the salesmen first sold Principal. An Area Manager testified as follows:

> THE INSPECTOR:
>
> You say introduce a company, which company is that?
>
> A The Principal Group of Companies.
>
> THE INSPECTOR:
>
> You weren't introducing FIC or Principal Trust or Principal Group; you were talking about your company, you refer to as the Principal Group, meaning not the Limited company, but the whole group of companies?
>
> A Everything, right to the ranch. [3472-3]

The sales force made extensive use of promotional materials which sold the Group and the products available through it. Salesmen were instructed to use the PGL Annual Reports [Exhibit 186], the 1985 Annual Review [Exhibit 11; 13144] and other Group related materials, including the Risk-Return Tradeoff Chart [Exhibit 249 at 364], product interest rate sheets [Exhibit 225 at 47(a)], brochures setting out the whole range of Principal products, [Exhibits 117 and 118], specific product brochures [Exhibits 113 and 112] newspaper and magazine articles, [656-7; 756] and a collection of booklets referred to as "The Richest Man in Babylon". [Exhibit 141]

After pitching the "Principal Group", salesmen were instructed to give each prospect the "full presentation", which included an explanation of the entire range of products available through the Group.

The salesmen sold the basic Principal concept, thrift, which included the following 3 "basic laws": "a part of all you earn is yours to keep", "pay yourself first" and "there is no better time to start saving than now". For example, an Area Manager described seminars conducted by the sales force as follows:

> The purpose of the seminar was to introduce to the public our company, what we believed in, what had made us strong over the 33- year period that we were in business, and primarily, it was based on Thrift, save 10¢ or 10% of every gross dollar that you earn, and the concept was called Thrift. Put your money away, if you do it over a long period of time, you will have the amount of money that you require when you retire. [3472]

Investors were encouraged to follow the Principal philosophy of diversification by investing the way Principal Group invested, that is in a balanced portfolio. It followed that investors were encouraged to diversify their investments among the various Principal products offered.

The explanation of the entire product line introduced investors to the mutual funds, PGL, FIC, AIC and PS&T. FIC and AIC were described as "covered under the Principal umbrella" [Exhibit 237; 2679-80] or "under the corporate umbrella of Principal Group". [1309] It was said that "Principal Group Limited was [the] umbrella company for all these [other] companies". [2577] The Principal umbrella concept was used by the sales force to promote the financial security of the subsidiary companies, including FIC and AIC, by implying that the strength of the entire Group stood behind each company therein. [165; 1256; 1446-7; 1580; 1959; 2164-5; 2680; 4778]

For example, after purchasing FIC certificates one investor received from her salesman what appeared to be a standard form letter addressed to "Dear Client", extolling the virtues of Principal Group, not FIC. [45] The letter stated, in part, as follows:

> May I take this opportunity to further introduce myself and tell you a little about Principal and myself? Principal has been in the financial services business for 31 years . . . Principal has had the financial strength, strategic planning and management strength to weather the storms and to capitalize on the opportunities . . . .
>
> In 1984, Principal announced record profits and shortly we will announce our 1985 profits, which we expect to be higher than 1984. The benefit to you is that you know Principal will be here to serve you. Your investments with us are secure. [Exhibit 2]

Other investors were also led to believe that Principal was strong or secure [379; 788; 2681] and that their investments were "safe and secure". [622; 1059; 1272] The following investor's testimony is illustrative of that evidence:

> We received the same type of information on the safety of our money with FIC and with Principal in general. And this I must emphasize, that when we talked to Mr. Cosman and to Mr. Smith on repeated occasions, we talked about the safety of our money. It [sic] was well aware our money was mainly in FIC. So when the replies came, it never came direct, oh, don't worry, FIC is fine. But it was, don't worry about Principal. It was the umbrella situation we were dealing with. That is why we concluded that it was all the group. [1757]

In describing the Principal line of products, salesmen often referred to the Risk-Return Tradeoff Chart, appended hereto as Schedule "H", which diagramatically compared the risk of each Principal product against the anticipated return. [Exhibit 249 at 364] PS&T term deposits and FIC and AIC term certificates were represented as safe, lower yielding investments while the mutual funds were represented as riskier, higher return investments. The Risk-Return Tradeoff Chart was prepared by Marlin. The covering memorandum distributing it to the sales force was authored by Wallace, Director of Branches [4299], and stated that the chart was designed with the following objectives in mind:

1) to better describe the products we sell;

2) to obtain balanced portfolios for clients;

3) to promote mutual fund sales;

4) to make our clients aware of the risk/return tradeoff. [Exhibit 249 at 362]

The order in which the products were presented was dictated by the commission structure. Mutual funds were presented first. Each mutual fund was compared to the others on the Risk-Return Tradeoff Chart in accordance with its anticipated return and risk. If the prospect had sufficient funds, PGL promissory notes were offered for sale. Thereafter FIC and AIC certificates and PS&T term deposits were presented for sale. In keeping with Principal's balanced portfolio concept, prospects were encouraged to purchase both mutual funds and a fixed income product.

The selling of Principal was further assisted by reference to the salesmen as "Principal Financial Consultants". Sales literature stressed that they were a "well trained professional group" [Exhibit 11] or "financial planners [who] help people decide how best to employ their discretionary earnings". [21465; Exhibit 68] The evidence shows that the reference was designed to assure investors that they were receiving financial advice from knowledgeable and qualified people and that their money, once invested, would be managed by a team of experienced, competent managers. It appears to have been successful. One investor testified:

> I would like to make it clear that my wife and myself are new at this game and that one of the reasons that I decided to go with Principal is because they offered financial consultants to advise people on what would be the best returns on their RRSPs or other investments. So I was probably looking more for advice and direction than a high rate of return. I was also looking for security of the RRSPs because it was my intention to use them as a supplement sometime down the road. [813]

This was supported by the evidence of salesmen. For example, one salesman testified:

> Q MR. WHITE: Good. All right. Now, what I'm going to suggest to you, sir, is that this describes exactly, whatever word you want to use, which [sic] you were doing for your clients. "The consultant helps people to draw up a blueprint for their financial security and gives them the opportunity to invest their money as the company does. Consultants advise clients on how best to structure their plans to place their financial houses in order using the four pillars of liquidity, safety, growth and protection. The consultant's advice is backed by the expertise of our investment, tax and legal departments." Sir, isn't that a fair description of what you were doing and how you were presenting yourself?
>
> A Yes, probably it is, yes. [2376]

"Guaranteed" and "Secure, Safe"

The evidence shows that the sales force promoted the concepts that investments in FIC and AIC were "guaranteed" and "secure" or "safe". The "guarantee" by FIC and AIC was purportedly backed up by so-called "protections" under the *ICA*.

One salesman testified that:

> And in hindsight, that's one thing that most definitely really becomes obvious in terms of people coming back after June 30th questioning the terminology, wording such as guarantee, secure, safe. All of these words, I found out later, were either misinterpreted, [or] misunderstood. There was a lot of misunderstanding in the public in regards to the terminology. [2470]

Marlin was asked about the use of the word "guarantee" and testified as follows:

> Q Now, we mentioned in the brochures the use of the word "guarantee". That was a word, I believe, you testified to that you liked?
>
> A Yes, that's right.
>
> Q It was a good word, wasn't it?
>
> A Good word.
>
> Q Sure. It was a good word because part of your competition, of course, were the trust companies and the banks that were also offering guaranteed investment certificates, correct?
>
> A That's correct.
>
> Q Of course, you wanted to be identified as closely with that market as possible because that was your competition, in terms of having deposits from people?
>
> A Yes, the word "guaranteed" had been used in the investment contract business since its inception, and we just continued to use it. It was a good word, and we saw no objection to using it. [13304-5]

Marlin explained the concepts of "guarantee" and "safety" in relation to FIC and AIC single pay certificates in a directive to the sales force dated February 22, 1979 as follows:

> There have been several inquiries received by or on behalf of prospective clients regarding the single payment certificates offered by First Investors or Associated Investors.
>
> The concern is with regard to the "guarantee" and the "safety" of the intended investment.
>
> While it seems to be clearly understood that CDIC does not cover certificates issued by an Investment Contract company or a Life Insurance company there is confusion regarding the reference to the Canadian and British Insurance Companys [sic] Act.
>
> *When answering inquiries, state clearly that First Investors and/or Associated Investors "guarantee" the principal and interest.*
>
> *The "safety" is assured by the quality of the investments permitted under the Investment Contracts Act. Assets equal to 100% of certificate liabilities are maintained with a Canadian Chartered Bank. Assets are invested in securities and mortgages that qualify under the Canadian and British Insurance Companys [sic] Act, the same as any Canadian Life Insurance company.*
>
> Sometimes too much explanation only leads to confusion and doubts, but *it is important to point out that CDIC is only applicable to deposit accepting companies, like banks and trust companies, and that Life Insurance and Investment Contract companies that accept funds under contract do not have and do not require any outside insurance of guarantee. The capital reserve and custodian requirements, as well as the quality of investments set out in the Investment Contract Act makes an investment with First Investors or Associated Investors a conservative safe investment.*
>
> It is also important to make sure the client knows into which of the Principal Group of Companies his investment is going. [Exhibit 248 at 32] [Emphasis added.]

This was followed by a further memorandum dated December 21, 1979 from Mitchell to the sales force which offered a similar explanation:

> **PROBLEM**: Regulatory authorities in certain locations are concerned with the way "Guarantee" on single pay Investment Certificates is being explained by some members of the sales force. Certain authorities are making test calls to determine what explanations

> are being used. The severity of this problem must not be misunderstood by any member of the sales force. Misleading explanations can result in the Company's operations being suspended!!
>
> **SOLUTION**: 1. Do not attempt to explain "Guarantee" over the phone. Without the assistance of our brochures etc., the client can too easily misunderstand the meaning of the concept. Simply emphasize the "safety" of the investment and ask them to come in to the office for greater clarification.
>
> 2. During the face-to-face appointment with the client if the "guarantee"/"safety" issue arises:
>
> (a) State that First Investors and/or Associated Investors "guarantee" the principal and interest.
>
> (b) *The "safety" of the client's investment with us is assured by the quality of investments which we in turn make with his money. Our investments are regulated by the Alberta Investment Contracts Act which is endorsed by each province in which AIC and FIC operate. It regulates our investments in the same way that Canadian Life Insurance Company investments are regulated.*
>
> (c) *If the client pursues the question of CDIC, respond that Investment Contract Companies like Canadian Life Insurance Companies do not have and do not require any outside insurance or guarantee. CDIC is only applicable to those institutions, such as banks and trust companies. [sic] which face the risk of having an unexpected run on withdrawals. Since our investment certificates are fixed term investments, withdrawals can be anticipated and funds can be made available in advance.* [Exhibit 264 at 6-7] [Emphasis added]

One further document found in the policies and procedures manual [Exhibit 252 at 730] was entitled "Two Types of Guarantees". The evidence was unclear as to who authored it. It referenced CDIC as the guarantee behind PS&T term deposits and chequing/savings amounts and explained the guarantee for FIC and AIC term certificates as follows:

> *Principal's other two term certificate issuing companies, Associated Investors and First Investors, are covered by the Investment Contracts Act. The provisions of this act are governed by the Canadian and British Insurance Companies Act, also a federal statute which, in turn, regulates the investments of Canadian Life Insurance companies.*
>
> *Specifically, this act states that all monies taken in on deposit must purchase certain securities, namely: Cash, Government bonds (federal, provincial, municipal, and school board), Church bonds, Treasury bills, Debentures and Bonds of some corporations if the company has had a 10-year success rate of paying for the bonds out of profits, and some first mortgages — up to 75% of assessed value.*
>
> *In Principal's case, these assets are held in custody by a chartered bank (Royal Bank for FI and Commerce for AI). Consequently, Principal can guarantee that 100% of deposits plus 4% interest are secured. That is, a depositor has the guarantee of the company which is backed by the quality of its securities.*
>
> For this reason, Associated and First Investors certificates are written up as 4% plus additional credits — as these additional credits fluctuate with interest rates, always leaving the 4% as the guaranteed minimum return.
>
> *As a further point, Canada Deposit Insurance is only applicable to deposits which face the risk of having an unexpected run on withdrawals. Since Associated Investors and First Investors are locked-in — fixed-term investments, withdrawals can be anticipated and funds can be made available in advance, consequently, a higher rate of return can be offered than that provided under CDIC.* [Exhibit 253 at 119] [Emphasis added.]

FIC and AIC term certificate brochures referred to the "guarantee" as follows:

> **Feature:** **Safety**
>
> **Benefits:** Your money is fully guaranteed.
>
> **Details:** First Investors Corporation Ltd. or Associated Investors of Canada Ltd. guarantee your principal and interest. [Exhibit 113]
>
> • • • • •
>
> **You Can Feel Secure!**
>
> First Investors Corporation Ltd. or Associated Investors of Canada Ltd. guarantee your principal and interest. [Exhibit 112]

The Presentation Manual stated:

> **Benefits:**
>
> **100% Security.** First Investors Corporation Ltd. or Associated Investors of Canada Ltd. guarantee your principal and interest. [Exhibit 138]

One Field Sales Manager considered the phrase "FIC and AIC guarantee your principal and interest" to be self-explanatory and did not instruct trainees with respect to the definition of "guarantee". He testified:

> Q Now, did you tell your sales trainees what that word meant, or was it self-explanatory?
>
> A "Guaranteed", I believe it was self-explanatory.
>
> Q What does it mean to you?
>
> A That those companies undertake to meet whatever obligations they have.
>
> Q With what?
>
> A With the assets of those companies; whatever those total assets were.
>
> Q Is there any particular assets that you have in mind as backing up this self-explanatory guarantee?
>
> A We believe that those companies had assets equal to 100 percent of their liabilities.
>
> Q So in your mind, was the word "guarantee" referable to the provisions of the Investment Contracts Act?
>
> A Yes.
>
> Q The Investment Contracts Act, in your mind, provided the guarantee or backed the guarantee?
>
> A It provided that there would be sufficient assets to meet the guarantee.
>
> Q So then, am I fair in saying that in your mind, your understanding was that this guarantee was provided by the Act and the Act provided, in addition, that there would be adequate assets there to enforce the guarantee?
>
> A I don't believe the Act provided the guarantee. The company provided the guarantee. I believe the Act meant that they would have the assets to meet it.
>
> Q No, you are quite right, and I am sorry. The Act provided the means by which the guarantee was to be met?
>
> A Yes.
>
> Q The Act provided the method?
>
> A It provided the assets to meet it, yes.

Q What was the source of that understanding of the meaning of the word "guarantee"? Was it ever explained to you or was it just something that you assumed because of the self-explanatory nature of this material?

A I believe it was something that was understood by everyone, without any specific explanation.

Q And is it a term, this term "guarantee", is it a term that you ever specifically explained, described to your trainees?

A I didn't define the word, no. [2831-2]

Other salesmen testified as follows:

Q As part of your training, sir, was the figure 104 percent used?

A Yes, that's correct.

Q In the context of what?

A That was the guarantee, and that was backed by the assets on deposit, that it was 100 percent principal and the 4 percent interest. [3739]

• • • • •

Q All right. Going back to page 12 of the Consumer and Corporate Affairs 2000 publication, sir, it does have a sentence under investment contract companies that says, therefore, money you invest with them is not insured. "No government guarantee exists to protect your investment." Do you see that?

A Yes, I do.

Q Was that something that you told to clients or prospects, sir?

A Yes, I would point out the fact that the money is not guaranteed by the government, that it's guaranteed by First and Associated Investors, but the protection was Investment Contracts Act. [2466-7]

• • • • •

A Well the guarantee was to be insured by the fact that the Investment Contracts Act would ensure that the money was there. That --

Q . . . So when you told them it was guaranteed, it was guaranteed because the Investment Contracts Act would ensure that they got their money?

A Would ensure that that guarantee would be fulfilled.

Q . . . to back up this guarantee was the Investment Contracts Act?

A Exactly. [2513]

• • • • •

Q The guarantee was a meaningless term?

A No, the guarantee, I think, is directly associated with the terms and conditions of the Act. [2736-7]

• • • • •

Q Did anyone ever ask you what will happen to their money if the institution runs into financial difficulty or goes out of business?

. . .

A I would have told them that, you know, that the investment is a safe investment, and from that point of view, the reasoning for that was is the fact that assets had to be

> maintained, and that with the Investment Contracts Act, that assurance should be there as well. So, you know, it was never looked at from the point of view that the institutions should ever go out of business. [2471]

The following memorandum dated December 23, 1985 from Tracy Barker of Internal Audit to Mitchell is particularly noteworthy:

> During my recent new employee presentation regarding the ABC product (December 11, 1985: Walter Reith accompanied by Tim Carruthers), I was concerned by what I believe to be misrepresentation of the nature of the FIC/AIC investments guarantee. I actively queried the representatives on this issue and through various statements was led to believe:
>
> (1) my full deposit plus 4% reserve was placed on deposit with Royal Bank and was therefore safe in a third party institution.
>
> (2) the deposit was not CDIC insured but that the FIC/AIC guarantee was better since it guaranteed 104% of my deposit.
>
> (3) there was no risk associated with my deposit and I was not affected by the success of FIC/AIC investment strategies. [Exhibit 253 at 37]

The evidence shows that insofar as FIC and AIC "guaranteed" the investment, it is clear that this was no guarantee in law, since no third party guarantor was involved. The real message intended to be conveyed to the sales force and investors was that investment in FIC and AIC was safe or secure by reason of the "protection" afforded by the requirements of the *ICA*. This "protection" is discussed below. The "protection" was also linked to the quality of the assets and the diversification of the companies' portfolio, which are discussed below and elsewhere in the Report. Of course, this was all in addition to the safety and security afforded by the Group and the business acumen of Donald Cormie.

There was some evidence that some investors understood the "protection" afforded by the *ICA* as meaning that the Government of Alberta provided some sort of guarantee. For example, one investor testified as follows:

> Q And it was invariably [the salesman's] practice to refer you to the back of the contract and what it said?
>
> A For the provincial government guarantee, yes, assets on deposit. [105-6]

And another:

> . . . . So weighing all these things together and his absolute guarantee that it was guaranteed by the Alberta Government, after that I did sign. I thought I had a pretty good deal. [565]

One salesman testified:

> Q No, I just want to know if you had in mind that there was any third party guaranteeing First Investors —
>
> A No, there was no third party. The government was doing it.
>
> Q Where in the pamphlet does it say the government was guaranteeing it?
>
> A Because of the Act that we are under here, the Investment Contracts Act, "Assets equal to . . . up to ". . . 100 percent of certificate liabilities . . . "are" . . . maintained on deposit with a government approved custodian. Assets are invested in securities which qualify under the Canadian . . . British Insurance Companies Act, the same regulations that govern Canadian life insurance companies.
>
> Q It doesn't say the government guarantees anything, does it?
>
> A No, you got that right. [2284-5]

"Assets on Deposit"

Closely linked to the concept of safety and security, and in my opinion the single most effective tool in selling FIC and AIC certificates, was the term on the top left back of the contract application form that dealt with the requirement under the *ICA* that assets be on deposit.

By at least February, 1979 the investment contract application form included a statement with respect to the protection offered to the investors in the following terms:

> Assets equal to 100% of certificate liabilities are maintained on deposit with a government approved custodian and invested in securities which qualify under the Canada and British Insurance Companies Act. These certificates are not covered by the Canada Deposit Insurance Corporation. [Exhibit 403 at 52]

Marlin testified that this wording was suggested by the regulators. [11874] Pointe, one of the Alberta regulators, testified that the companies requested that wording be inserted on the form. [28494] The evidence supports Pointe's recollection. It seems clear that the reference to assets on deposit equal to 100% of certificate liabilities was included on the contract application form and emphasized in selling FIC and AIC products in order to counteract the lack of CDIC coverage. In fact, Marlin admitted as much in his testimony. [11663]

By December, 1980 the wording on the contract application form had further evolved. Gone were the references to the custodian being "government approved" and the *CBICA*. In their place were references to the *ICA*, a Canadian chartered bank and life insurance companies, as follows:

> First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank. Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies. THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION. [Exhibit 403 at 128]

In late 1984, a further change was made to the back of the contract application form at the request of the Superintendent of Insurance, following which the term read:

> I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company *is required to maintain* assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION. [Exhibit 403 at 255] [Emphasis added]

This wording remained on the contract application form until the demise of FIC and AIC. How the 1984 change came to be made and its significance is discussed later in the Report.

Similar statements were made in FIC and AIC term certificate brochures. The brochure in use from 1980 to 1985 stated that:

> First Investors Corporation Ltd. or Associated Investors of Canada Ltd. guarantee your principal and interest. Assets equal to 100% of certificate liabilities are maintained on deposit with a government approved custodian.
>
> Assets are invested in securities and mortgages which qualify under the Canadian and British Insurance Companies Acts [sic], the same regulations that govern Canadian Life insurance companies. Since investment contract companies like First and Associated and life insurance companies do not accept demand deposits their products are not covered by the provisions of the Canada Deposit Insurance Corporation. [Exhibit 113]

In a subsequent brochure the wording was varied to read as follows:

> First Investors and Associated Investors are investment contract companies and are regulated by the Investment Contract Act. Assets equal to 100 per cent of certificate liabilities must be maintained on deposit with a government approved custodian. Assets are invested in securities which qualify under the Canadian and British Insurance Companies Act, the same regulations that govern Canadian life insurance companies. Products offered by investment contract companies and life insurance companies are not covered by the provisions of the Canada Deposit Insurance Corporation. [Exhibit 112]

These wordings were in contrast to the statements found in accumulation plan brochures from the early 1970s [1638], as evidenced by Exhibit 114:

> Principal believes its fundamental duty is to preserve your savings in the safest possible investments. The savings of people like yourself are invested in only safe investments that qualify under the Canadian and British Insurance Company Act (Canada) and it maintains at all times a segregated deposit with a Canadian Chartered bank equal to 100% of its guaranteed cash value. . . .

Product information materials provided to the sales force contained similar statements in respect of the protection offered on FIC and AIC products. By memorandum to Area Vice Presidents and Branch Managers dated May 23, 1985 Noble described the security of FIC and AIC term certificates as follows:

> The security of a client's investment in a term certificate arises from several sources:
>
> a) The quality of the Compnay's [sic] management.
>
> b) The quality of the investments held by the Company. AIC & FIC are required by government regulation to keep assets on deposit with a Custodian equal to certificate liabilities.
>
> c) The fact that AIC & FIC are not deposit taking institutions. They offer investment contracts which, unlike demand deposits, are not subject to sudden "runs" or panic withdrawals which can suddenly cripple a deposit taking institution with high demand deposits.
>
> d) As noted earlier, we are required to hold AIC/FIC assets with a Custodian (in our case the Royal Bank). This adds a further element of security. [Exhibit 250 at 105-7]

A product description update dated October 22, 1985 for insertion into the Basic Manual advised as follows:

> Security Offered on FIC/AIC Products: FIC/AIC are investment contract companies. Investment contract companies are like life insurance companies. They do not accept deposits requiring liquidity, but issue only annuities and term contracts which do not have the risk of a run on withdrawals because maturities can be anticipated and funds made available in advance. Investment contract companies are regulated by the Investment Contracts Act. Assets equal to 100 per cent of certificate liabilities must be maintained on deposit with a government approved custodian (a Canadian chartered bank) and they must be invested in securities which qualify under the Canadian and British Insurance Companies Act, the same regulations that govern Canadian life insurance companies. This protection has been deemed sufficient and extra insurance (such as CDIC) has not been considered necessary for investment contract and life insurance companies. [Exhibit 264 at 740]

It is apparent that the references to assets on deposit derived from section 8(c) of the *ICA*, which provides that:

> 8 No company shall be registered under this Act as an issuer, unless . . .
>
> (c) arrangements satisfactory to the Superintendent have been made for the deposit with a trust company, bank or other suitable depository or depositories within

> Canada of qualified assets approved by the Superintendent aggregating in amount, when valued as provided in section 29, not less at any time than the amount for which the company, under the terms of its investment contracts, is liable as of that time to pay in cash to the holders of all its investment contracts then outstanding, but in the case of a company that maintains with a trust company, bank or other suitable depository outside Alberta, but within Canada, a deposit or deposits of qualified assets in such an aggregate amount, no further deposit shall be required, and . . .

The evidence tends to show that the sales force was trained and regularly reminded to refer each prospect to the back of the contract application form and the representation respecting assets on deposit. When the salesman had explained the term, he would so indicate on the form by marking the appropriate box. The evidence of the investors and salesmen who testified was almost universal to the effect that the representation was referred to and the box checked.

The most common explanations provided were that assets of a value equal to the principal or principal plus 4% were purchased and deposited with a custodian. [952; 1636; 1734; 2552; 4110-1] Illustrative of such an understanding on the part of the sales force was the evidence of one salesman as follows:

> Q So just to put it into simple terms, if I am an investment contract holder and give you $100,000 to buy a one-year investment contract, what is the obligation of First Investors?
>
> A To put in $100,000 worth of assets. [3431]

An internal memorandum dated July 28, 1986 circulated in at least one Area, instructed as follows:

> Since every dollar deposited, plus the first 4% of the interest is "matched" dollar for dollar with qualified assets, there is complete protection of your investment. . . . [Exhibit 233 at 9]

The notes for trainers contained in the Basic Manual used in at least one Area are particularly instructive:

> 1. Term Certificates & Additional Credit Term Certificates
>
> A. Assets equal to 100% of certificate liabilities as offered by both A.I.C. and F.I.C. are maintained on deposit with the government approved custodian and invested in securities which qualify under the Canadian and British Insurance Companies Act.
>
> B. *Certificate*
> *Liabilities = Principal amount of money ($) invested plus the guaranteed 4% = Certificate Liabilities. (Re: Add'l Cr. Term Certificates)*
>
> *a. Certificate Liabilities on a ONE YEAR = Principal amount of money ($) invested plus the full GTD rate.*
>
> — See Memorandum re: K.N. Marlin — CDIC as opposed to Investment Contracts Companies — Refer to (Evening/Day Two (2))
>
> • • • • •
>
> — We can Raise & Lower Additional Credits. [Exhibit 237 at 127] [Emphasis added]

The Manager of Recruitment and Training in the Northlands Area testified that this definition of certificate liabilities was consistent with her understanding, which she acquired from what she was told when she joined the Group in 1986. [3313-4; 3363-4]

There is evidence that these understandings were held at all levels of PCL management. The Area Manager of Northlands used training materials which included a script with the phrase that "we must put your principal plus 4 percent of the interest on reserve with a government approved custodian". [4109] Moulton, Vice President, Field Operations of PCL, testified as follows:

Q . . . if today I put $100,000 into an FIC contract, tomorrow what is the deposit requirement for that $100,000, as you understand it?

A Well, as I understood it — I understood it that the full principal would be included.

Q Plus some interest, that is, 4 percent or more or less?

A As it accrued over time, but I am not sure, again, how the calculation was made. [4903-4]

While FIC and AIC did have depositories at the Canadian Imperial Bank of Commerce and Royal Bank wherein the documents evidencing title to the assets were kept, the evidence tends to show that at least by December 31, 1983 and thereafter until June 30, 1987 neither the investors' principal nor principal plus 4% were on deposit, nor were the companies' assets equal to either value. The value of what was on deposit in the way of assets is reviewed later in the Report.

Marlin's evidence with respect to the "certificate liabilities" was that when the *ICA* was drafted and all certificates had a cash surrender value, s. 8(c) was easy to interpret and apply; the cash surrender values of the accumulation certificates were what were maintained on deposit. He testified that from the late 1970s, when most of the certificates sold were single pay certificates with no cash surrender value, the wording of s. 8(c) became "rather meaningless or certainly subject to misunderstanding". [11882]

Marlin testified as follows:

A Certificate liability came to mean the payment due to the certificate holder at that time. Current certificate liability doesn't mean the amount that you have put in plus the interest, it means how much is payable to that certificate holder at that particular time.

Q MR. WHITE: Let me ask it in this way. Certificate liability, as you understand it, means one of two things. It either means the cash surrender value of the certificate, that is one possible definition, right?

A That is right.

Q And the cash surrender value of a Single Pay term certificate is zero, right?

A Right.

Q Therefore, to say a certificate liability is the principal amount of money plus the guaranteed 4 percent would be wrong if we are using cash surrender value because the principal amount of money invested on a thousand dollar certificate is $1,000. The 4 percent is what, $40? So by this definition, certificate liability would be $1,040, wouldn't it?

A That is correct.

Q But under the cash surrender value definition, the certificate liability is zero, right?

A That is right.

Q There is another definition of certificate liabilities and that is the -- call it the present value formula or the maturity value formula, correct?

A That's correct.

Q For the same thousand dollar certificate, the way we calculate the maturity value formula is we say, okay, if we have to pay out $1,040 a year from now, how much do we have to deposit now at 6 percent to give us that number?

A That's correct.

Q It works out to about $967, correct?

A I believe that is right, yes.

Q Therefore, using the maturity value formula, certificate liabilities would equal $967?

A That is correct.

Q Not the 1,040 represented by this?

A Yes.

MR. WHITE: Does that help, Mr. Code?

THE INSPECTOR:

> That helps a bit, but I make my own, and that is, you said earlier all of the people were told that this is what certificate liabilities meant.
>
> Where did you ever tell any salesmen that certificate liability meant the cash value or something other than what is defined right there? I don't recall seeing any document anywhere.

Q MR. WHITE: They never were, were they?

A No, they weren't told. [13608-10]

And further:

Q MR. WHITE: I am going to move a little bit ahead in this examination. Let me ask you this. You are saying that an understanding that certificate liabilities equals the principal amount of the investment plus 4 percent is easily taken from the wording on the back of the certificate?

A I would say that it is easy to take that from it. [13612-3]

Elsewhere in testimony, Marlin conceded that based on his interpretation of s. 8(c) and the statement on the back of the form, a minimum value of assets were required to be on deposit; it was sufficient to have enough assets on deposit to meet the cash surrender value on the accumulation plans which, after 1978, made up a very small proportion of FIC and AIC sales and to meet any single pay certificate maturities for the following 30 days. Marlin agreed that it was "not much of a boast". [13579]

Marlin used the same "easily misunderstood" wording [13630-1] in a 1983 instructional videotape for the sales force entitled "Depositor's Protection". [Exhibit 392] The videotape was authored by Marlin, who testified that it was "off the top of my head". [13257] The covering memorandum to the videotape dated October 18, 1983 stated as follows:

> The Public is concerned with the protection of and insurance on their investment or capital. We know that you are constantly asked the question, "How is my money insured if I invest with First Investors Corp. or Associated Investors Corp.?" In order to assist you in under standing the differences between the various deposit taking institutions and in handling any objections in your presentation, we have prepared the "Depositor's Protection" tape. Mr. Marlin takes you step-by-step through each institution with an explanation of Specified Investments, Capital Ration [sic] Requirements, Custodian Held Assets, Assumed Rate Reserve, Qualified Investment Under the Canadian & British Act, [sic] CDIC and Special Insurance Fund. [Exhibit 392]

In the videotape Marlin stated as follows:

> During this session today, *I'm going to introduce a training and selling tool that I think will be very useful in explaining and understanding the role that government plays in protecting depositors*. This grid chart we have here will be reproduced, along with an explanation of the various categories and included in the basic manual for reference, in case someone wants a more detailed explanation during a presentation. [13249] [Emphasis added]

And further:

> . . . the Investment Contracts Act calls for assets to be held by a custodian. The type of assets specified are to be held by a custodian in an amount equal to the 100 percent of certificate liabilities, and it's held on behalf of the certificate holders jointly, which is an added feature that is not applicable to trust companies or banks. [13255]

Marlin tried to lay the blame for the wording on the back of the contract application form on the shoulders of the regulators. He testified:

> Q You are saying that the box at the -- the little box that they checked off on the contract, the regulators approved that, but you understood that it may lead to the wrong impression, but that was the regulator's problem, correct?
>
> A That is the way that they wanted us to present it, obviously, yes.
>
> Q That is the way they wanted to present it. As you have already told me, sir, and I agree with you, it is easy to misunderstand what that little paragraph means, isn't it?
>
> A Yes, it is.
>
> Q In other words, you are saying, sir, a person just reading that paragraph could easily have a misunderstanding, correct?
>
> A Yes, that is true. [13614-5]

In fact, the evidence tends to shows that Marlin was quite content to let the sales force think and advise investors that principal or principal plus 4% was on deposit. He testified:

> Q I am going to put to you that when the wording was suggested by the regulators it was confusing, you knew it was confusing, but it was confusing to your advantage because it led your sales staff and, ultimately, your customers to believe that they had a $1.04 on deposit for every dollar they invested. You knew that is what they thought and that suited you just fine, Mr. Marlin.
>
> A Yes, obviously that was the message they got.
>
> Q That was a message you knew they would get from that wording, wasn't it?
>
> A Yes, I guess that is the message that a layman reading it would get. [13634]

The evidence tends to show that Marlin knew that the sales force was representing the value of the assets held on deposit to be equal to principal or principal plus 4%. He encouraged and condoned the making of such representations. The evidence tends to show that this conduct on his part was both dishonest and fraudulent as he knew that the representations were false and would be relied on by investors.

The evidence tends to show that the existence of a depository proved persuasive to some investors. Marlin agreed with the proposition that the representation that assets were on deposit in a Canadian chartered bank was probably the strongest selling point as to the safety of the investment. [13298] In the "Depositor's Protection" videotape and accompanying grid chart the existence of a custodian was represented as a protection for the investor. At least one investor was actually shown the grid chart. [1154-5] The grid chart is appended hereto as Schedule "I". [Exhibit 392] It depicted the so-called "government protections" offered by the various products.

One investor testified as follows:

> Q Right. And how did it come about that it was pointed out that the custodian was the Royal Bank?
>
> A I was pretty concerned about it because I have never invested in anything except something that's covered under the Canada Deposit Corporation, so I inquired about this, what was written on the back about this — the assets to be held at the Royal Bank

> to equal the liabilities, and she said the Royal Bank — she said this was as safe as the Royal Bank is, that that would have to crumble before this thing would be — any money could be lost. [683]

Another testified:

> Q And was there any mention with respect to the deposit of the assets with a Canadian Chartered bank? Was the bank named?
>
> A Oh, yes, he told me that my monies is [sic] going into the Royal Bank and it's like -- I asked him, well, what do they do with it? He said, all your money is kept in a vault, like in a bag with your name on it. And I says, what happens if the company goes under? He says, well you don't have to worry, your money is there. He says, plus, you got the certificate saying that it's guaranteed by the government. [721-2]

Notwithstanding the grid chart, the evidence tends to show that Marlin did not regard the requirement of a depository or custodian as important for the protection of investors. In commenting on the fact that some of the assets of FIC and AIC were held in a depository outside of Canada, he stated that he did not feel that the fact that the assets were held in the United States was prejudicial to investors and added that "we . . . didn't feel it added any additional protection". [11894] In fact, Marlin regarded the depository or custodian arrangement as obsolete and merely a carry-over from the days before the *ICA* when investment contract companies were regulated by the Board of the Public Utilities Commissioners. [11710; 11792; 11821] According to Marlin, the shift to single pay certificates which had no cash-out privileges rendered the requirement of a depository in the *ICA* meaningless. [11823] Nonetheless, Marlin encouraged the sales force to represent to investors that the depository offered additional protection.

Despite a request by the regulators that references to the custodian being "government approved" be removed from the contract application forms and brochures, the evidence tends to show that the statement continued to be used by the sales force in presentations to prospects. [2642; 4111] PCL's top salesman for many years testified that:

> A I would say that your First Investors Corporation that is governed by the Provincial Government under the Investment Contracts Act, that for every dollar you deposit, we must maintain an equal dollar in deposit through a government-approved custodian. There was a constant audit and a full every three months.
>
> Q Just slow down. An equal dollar on deposit with a government custodian?
>
> A An equal dollar in assets. [2240]

There was some evidence that some investors were told the custodian was a government custodian. [656] PCL's top salesman further testified that he represented to one investor that the custodian:

> . . . was a government custodian who oversaw and maintained the amount of my deposit or the total principal amount plus the interest. [2306]

In his "Depositor's Protection" videotape Marlin also referred to a capital ratio as another of the "government protections". Marlin stated that the regulators asked for capital ratio in addition to the basic $500,000 capital required under the *ICA*. The grid chart checked off "capital ratio requirement" as a protection. The evidence shows that in fact FIC and AIC were not complying with the regulators' request and were not adhering to a capital ratio. This was known by Marlin. The evidence tends to show that he acted dishonestly and fraudulently in representing to the sales force that the companies observed a capital ratio, with the intent that they make the representation to investors, when he knew it was not true.

Pursuant to s. 34 of the *ICA*, FIC and AIC were required for the most part to invest their funds in investments in which a company registered under the *CBICA* may invest its funds. Certain of the above quoted contract application forms, brochures and other promotional materials referred to the assets on deposit as assets which qualified under the *CBICA* or were of a type permitted to Canadian incorporated life insurance companies. [Exhibits 112; 113; 114; 237 at 125-7; 264 at 740; 292; 403 at 52 and 128] The evidence tends to show that commencing in 1984, FIC and AIC acquired significant amounts of related party assets, including non or low performing shares in Matrix, PNI and AHL and high risk collateral loans due from PGL, which were not in fact qualified under the *CBICA* or permitted to Canadian incorporated life insurance companies by reason of s. 52 [formerly s. 33] of the *CBICA*. Thus while FIC and AIC emphasized in their dealings with regulators that AHL preferred shares were assets permitted of investment contract companies, the public position was that the companies invested in assets permitted of Canadian incorporated life insurance companies. This was, the evidence tends to show, not true. These assets and how they were acquired are described later in the Report.

Investment Strategy and Quality of Assets

The evidence shows that explanations of the investment strategies of the Group and the mix of assets in the Group's portfolios were used to sell FIC and AIC certificates. That was confirmed by the 1985 Annual Review which stated:

> Very few financial institutions are able to employ a marketing strategy that clearly reveals their investment strategies to their clients. At Principal, our investment strategies are proudly presented to our clients in a complete and detailed manner by our financial consultants. [Exhibit 11]

Little was said about the specific investment strategies and portfolios of FIC and AIC. For example, one Field Sales Manager stated that although he was taught and in turn taught others that each company in the Group was separate and distinct, he was not informed nor could he inform his trainees or Levels 1 and 2 salesmen as to which company held which assets. [2826] Marlin testified that:

> . . . it was certainly not the intention that any salesman would discuss the portfolios of First or Associated with the public, I think you would find, in talking to them, that they were not equipped to talk to them about that. [13488]

This emphasis on the assets of the Group rather than FIC and AIC was illustrated by the "coin" in the 1985 Annual Review depicting the distribution of the Group's assets under administration. [Exhibit 11] There was no similar breakdown showing the asset mix of FIC and AIC.

The basis of the investment strategies of Principal was said to be the cycle theory. [Exhibit 226 at 47] This theory was marketed by the sales force in their sales presentations, by the Marketing Department in their brochures and pamphlets and by Donald Cormie in public lectures and newspaper and magazine articles. Marlin testified that:

> . . . we made it a point that our sales representatives did present the cycle, economic cycle theories and, consequently, indicated what the stress was and why we were doing certain things, the idea being to say, look, we don't make short-term decisions on investments, we have a strategy, and this is what it is. They could well present that strategy. [13488]

Of particular significance was the representation that Donald Cormie and the Group had foreseen the real estate collapse and had disposed of real estate by the late 1970s and early 1980s. [137; 167; 269; 346; 763; 1013; 1874] Illustrative of the representation was the following passage from Donald Cormie's Chairman's Message in the 1985 Annual Review:

> . . . Principal Group manages our clients' investments and our corporate portfolio using in depth analysis of long-term cycles and trends within our economy. By understanding these trends, we have been able to act rather than react. *Our success in moving out of real estate in advance of its subsequent collapse and moving into the stock and bond market at its low points are examples of how this strategic planning works for us and our clients.*

> We continually monitor current cycles and trends within our economy and adjust our strategies accordingly. [Exhibit 11] [Emphasis added]

When asked what holdings in real estate and mortgages were in the portfolios of FIC and AIC, salesmen testified that they believed that the Group and its members had sold off their real estate by the early 1980s. [2448-9; 2673-4; 2822-6; 2917-8] One salesman stated that she understood that the asset mix included:

> . . . marketable securities, low-risk, high-yield Government of Canada bonds, commercial paper, Treasury bills, those types of safe, low-risk, high-yield investments that protected the client's money during the real estate crisis. [37075]

What was not stated in the Chairman's Message was that the Group got out of real estate and into mortgages. [16690-1; 21362] The evidence tends to show that either the distinction between real estate and mortgages was not communicated to the sales force, and in turn investors, or it was represented that Principal was out of both real estate and mortgages. [104; 137; 167; 237; 254; 284; 413; 543; 763; 1013; 1311; 1356; 1369; 1490; 1874] Nor was it stated that by the end of 1983 and continuing thereafter at ever escalating rates, the Group was acquiring huge amounts of foreclosed property or real estate.

Marlin testified as follows:

> Q Now, you're aware that Principal Group promoted the idea that Donald Cormie had a cycle theory?
>
> A Yes, that was no secret.
>
> Q And because of this cycle theory, it was possible for Mr. Cormie, and hence, the Principal Group to foresee changes in the economy?
>
> A Yes, that was, I think, an accepted fact.
>
> Q Was it not, sir, represented to the public that this cycle theory had enabled Mr. Cormie and the Principal Group to foresee the real estate collapse, and hence, to get out of mortgages and real estate?
>
> A Yes, there was mention of the fact that Principal Group had disposed of its real estate. That comment was based on the fact that the real estate held by Principal Group Limited had all been disposed of by the late '70s.
>
> Q Yes, and the public was to believe that when they were told the Principal Group had disposed of its real estate, that that, of course, included the investment contract companies?
>
> A At that time the investment contract companies had mortgages on real estate, not real estate.
>
> Q Was that a candid approach to the problem?
>
> A Yes, I believe it is. There's quite a difference between mortgages and real estate.
>
> Q Let's take this in two steps. First of all, you will agree with me that the public was led to believe that in the late '70s, Principal Group had disposed of all or almost all of its real estate holdings, correct?
>
> A That's correct.
>
> Q And, of course, in referring to Principal Group, we're not referring just to Principal Group Limited, but to all of its constituent parts?
>
> A Yes, that would be inferred.

Q That would include the investment contract companies?

A That wasn't mentioned specifically, but it would include them, yes.

Q So the public having been told that the Principal Group, including the investment contract companies, had disposed of all or almost all of their real estate holdings in the late '70s, you then say, ah-hah, but we didn't ever say mortgages, because there's a different. Is that it?

A No, I think that to say that we had disposed of all the real estate was not an inaccurate statement, and it was not designed to mislead people to the fact that we had mortgages.

Q Well, then, why didn't you go on and say, well, you know, because of the cycle theory, we were able to see that the real estate market was going to crash, so we got rid of our real estate holdings, mind you, we kept our mortgages. You didn't say that?

A No, that's true, but we were --

Q Yes, but having undertaken to tell the public something, why didn't you tell them the whole story? Mr. Marlin, isn't that the problem, you want to tell half the story all the time?

A With the benefit of hindsight, I can see where you're coming from, but I'll tell you this. At the time, we believed that the lending that we were doing was prudent and that it was -- we weren't taking undue risks. The ratio of lending to the value, the perceived value at that time was conservative. We didn't anticipate that we were lending money on property that we would own within two years.

Q I realize you made a mistake. But after you realized that you were stuck with a lot of property because of mortgages, you continued to lead the public to believe, didn't you, that the cycle theory had enabled you people to avoid the real estate problem, right?

A That perception did get through, I admit. I'm saying that was not an intentional ploy to mislead people. [13530-3]

I reject this. The evidence tends to show that a deliberate effort was made by Donald Cormie and Marlin to hide the real estate and mortgages crisis facing the Group and lead investors to believe that the Group, including FIC and AIC, had escaped the effects of the real estate collapse. The evidence tends to show that this conduct on their part was both dishonest and fraudulent.

The 1982 PGL Annual Report [Exhibit 186] depicted the average investment mix of the Group's consolidated assets for the previous 7 years as follows:

AVERAGE INVESTMENT MIX OF PRINCIPAL GROUP LTD.'S CONSOLIDATED ASSETS FOR THE PAST SEVEN YEARS

	7 Year Average	1982	1981	1980	1979	1978	1977	1976
LIQUID/ CASHABLE ASSETS	7%	11%	4%	6%	10%	11%	3%	4%
REAL ESTATE AND OTHER ASSETS	8%	11%	12%	8%	6%	6%	8%	8%
SAFE-FIXED INCOME INVESTMENTS, MORTGAGES AND SECURED LOANS	47%	50%	47%	39%	40%	42%	54%	57%
COMMON AND PREFERRED SHARES	12%	8%	14%	16%	15%	12%	8%	9%
HIGH-YIELDING CASHABLE INVESTMENTS, GOVERNMENT OF CANADA BONDS AND CORPORATE BONDS	26%	20%	23%	31%	29%	29%	27%	22%

Specific reference was made to the portfolios of FIC and AIC as follows:

> During the last five years management has analyzed trends in the economy and has realigned the companies' investments to take advantage of exceptional investment opportunities in the North American stock markets. Both First and Associated have adopted more dynamic common stock and bond portfolios based upon their parent company's sophisticated economic projections of major market moves in the 1980s.
>
> As a result of this strategy both firms have a high degree of liquidity in non-mortgage investments in addition to well positioned, high yielding mortgage portfolios.

No PGL Annual Report was published for 1983. The 1984 PGL Annual Report [Exhibit 186] reported as follows:

> First Investors had an excellent year in 1984, reflecting the corporate strategy of diversifying investments into superior quality corporate bonds and stocks, and de-emphasizing mortgage lending.
>
> The company holds over 52 per cent of its assets in liquid, high yielding cash securities and fully secured collateral loans . . . .

A Special Bulletin to the sales force, prepared by Petracca [11558; 11690-1] and issued by Marlin, announcing the release of the 1984 audited financial statements for FIC, stated that:

> The Company's portfolio of Canadian government and superior quality corporate bonds provides a high degree of liquidity. New funds are being invested into the bond and security market where returns are perceived as safer, more liquid and higher than current mortgage investments, and also into demand loans secured by liquidable securities. [Exhibit 23]

A similar, but not identical, Special Bulletin was issued with respect to AIC. [Exhibit 23]

One salesman testified that the issuance of these Special Bulletins was the only occasion in 29 years where separate financial information about FIC, AIC and PS&T had been provided. He understood the reason to be to give the sales force confidence about the assets, liabilities and income of the companies. [2276-7]

The evidence tends to show that the statements in the 1984 Annual Report and Special Bulletins were not true. Further, what was not disclosed in these documents or indeed in any references to the performance of the Group or FIC and AIC in 1984, was that as at December 31, 1984 mortgages and owned property from foreclosures accounted for 46.9% of FIC's total assets and 55.5% of AIC's total assets. [Exhibit 550 at 310; Exhibit 551 at 453]

The 1985 Annual Review stated under the heading "Investment Contract and Thrift Services":

> Corporate investments are currently concentrated in bonds and securities offering excellent liquid returns. Because of the need for a balanced portfolio of secure investments, a large part of these companies' assets are in government and corporate bonds as well as blue chip stocks. Management's experience and financial expertise ensure the profitability of the Companies' investments and a safe, competitive yield to the certificate holders. [Exhibit 11]

The evidence shows that the statement was not true. The investments of FIC and AIC were not concentrated in bonds and securities. [Exhibit 272 at 16; Exhibit 273 at 15] Further, FIC and AIC were not profitable in 1985. FIC incurred a net loss of $8,448,447 while AIC incurred a net loss of $2,622,805. [Exhibit 272 at 15; Exhibit 273 at 16]

The evidence shows that Petracca was involved in drafting this section of the Annual Review. [10708-13; 11029] An earlier version stated that "Investments are currently being made in bonds and securities . . ." rather than the "currently concentrated" reference found in the final version. [Exhibit 379 at G65-7] Petracca testified that what she meant to convey was that the Group was currently concentrating new investment in bonds and securities; in retrospect she considered her rewording to be "somewhat less than prudent". [11029-30] Donald Cormie's evidence was that although he reviewed earlier drafts, he did not see or approve the final version. [16657] Marlin's evidence was similar. [11779-81] Further reference to approval of the Annual Review is found below.

CDIC Comparisons

A number of the investors who gave evidence at the hearings testified as to representations made by salesmen comparing the protection offered by the *ICA* versus that provided by CDIC. The main representations were as follows:

(i) That CDIC coverage was not necessary given the requirements of the *ICA*; [Exhibit 80 at 33; Exhibit 233 at 9; Exhibit 264 at 6]

(ii) That the protection offered was as safe as or better than CDIC; [85; 96; 108-9; 236; 377; 655; 721; 758; 782; 963; 1104; 1120; 1489; 1636; 2145; 2472; 2683; 2722]

(iii) That CDIC was in financial difficulty; [755-6; 1126; 1231; 1313; 1499; 1702; 1728; 2260-2; 2507; Exhibit 233 at 9]

One investor testified that he was told that there was CDIC coverage on his investments in FIC and AIC certificates. [863-5]

In a directive from Marlin to the sales force dated December 20, 1978 and included in the training materials for new recruits, he stated as follows:

> To: All Sales Force
>
> The following should be used when explaining how CDIC relates to our various investments.
>
> **BANKS AND TRUST COMPANIES** that accept deposits require a high degree of liquidity to meet a possible run on withdrawals. To protect the investing public from loss should such a run occur, CDIC has been established by the Government to provide a fund to insure up to $20,000.00 [later $60,000.00] of an investor's deposit or investment for a five year term or less with each company.
>
> **LIFE INSURANCE AND INVESTMENT CONTRACT** companies that do not accept deposits and issue only policies, annuities and term contracts do not have the same risk of a run on withdrawals. The fact that these are regulated companies that must invest in securities authorized under the Canadian and British Insurance Companies Act provides further protection for the investor to the point that CDIC or other insurance, up to this point in time, has not been considered necessary. [Exhibit 248 at 31]

Similar statements were contained in other memoranda and materials distributed to the sales force and a similar message conveyed in Marlin's "Depositor's Protection" videotape. [Exhibits 231 at 40; 194; 252 at 400; 248 at 55-6; 392]

In a memorandum dated July 28, 1986 with respect to "AIC/FIC Protection", circulated to all staff in the Foothills Area, the following was said about CDIC:

> . . . Since companies like AIC and FIC and life insurance companies do not accept demand deposits, they do not require the insurance. [Exhibit 233 at 9]

In turn, such statements were communicated to investors. For example, one investor testified that he received a letter from PS&T's customer relations department which stated:

> This Act requires that the Company must invest in securities authorized under the Act, which provides further protection for the investor to the point that C.I.D.C. [sic] or other insurance, up to this point in time, has not been considered necessary. [Exhibit 80 at 32]

One salesman testified that she was trained and received ongoing instruction to:

> . . . tell our clients that they were actually safer investments than CDIC because of this 100 percent coverage and 4 percent of their interest on top of that was covered by this different form of insurance. [37071]

In 1982 Marlin advised Superintendent of Insurance Kaiser and Pointe, another regulator, that it would be beneficial to separate the single pay business from the accumulation business into different companies in order to obtain CDIC coverage for the single pay business. The regulators indicated that CDIC coverage was desirable. [12632] In 1981 or 1982 Marlin approached CDIC "with the idea of attempting to qualify for CDIC coverage". [12631] He testified that he was advised that CDIC coverage was not available for investment contract companies.

When asked why the sales force was trained to say that the other protection was "deemed sufficient", Marlin stated that it was sufficient as far as the Group was concerned and in the absence of complaints from regulators, investors or salesmen. [11664-5]

Additional Credits

The evidence shows that two significant representations were made with respect to additional credits:

1) That the additional credits had never in the history of FIC and AIC not been paid;

2) That the additional credits were paid from profits.

The evidence tends to show that neither of these were true.

The training materials contained the following mock presentation of the additional credits concept which one salesman testified was consistent with the approach to be taken in selling FIC and AIC [4189]:

ADDITIONAL CREDIT PRESENTATION

A client has come into the office. He wishes to invest $40,000.00 for a five year deposit with an annual payout of the interest.

S/R: "Hello Mr. *(client)*. How are you today?"

client: "Not too bad. Yourself."

S/R: "I'm just fine. My name is . . . . and when we talked on the telephone the other day, you had indicated at that time that you were interested in investing $40,000.00 into a five year certificate."

client: "Yes. Just sort of checking around to see what the rates are."

S/R: "O.K. Is this money which you have available now?"

client: "Yes."

S/R: "Our best interest rate currently is the five year with an annual payout of the interest at ____ %."

client: "And that's guaranteed?"

S/R: "Well, have you ever dealt with us before Mr. *(client)*?"

client: "No, I haven't."

S/R: "This particular certificate is issued under First Investors Corporation which is a company of the Principal Group. We're made up of a number of companies — Principal Savings and Trust, First Investors, and Associated Investors are included in the Principal family of companies.

The first part of the certificate is a base rate of 4%. The second part of the certificate is referred to as Additional Credits. The additional credits on this particular certificate would be __%. That totals up to __% paid annually."

client: "Why do you separate the two?"

S/R: "When we originally started offering these certificates, 4% was our base rate. The government said to us at that time, "If you want to keep competitive as interest rates rise, you can offer Additional Credits over and above that 4% base rate."

The second reason is to protect you, the investor. *We must put your principal plus 4% of the interest on reserve with a government approved custodian. Then we can only invest in investments that are qualified under what is called The Canadian and British Insurance Companies Act.* The Additional Credits we do not have to put on reserve. Technically they are therefore not guaranteed. *The company's intention is to honor them and we have always honored them."*

client: "So I could end up with just 4% of my money if you people didn't decide to honor the Additional Credits."

S/R: "Legally, yes, you could Mr. *(client)*. As I said before, the company's intentions are to honor the Additional Credits, but we don't have to put the additional credits on reserve. We cannot say that they are guaranteed."

client: "So, you say in five years down the road an investor could be getting Additional Credits for three or four years and then something happens to the company and I could lose my Additional Credits."

S/R: "Yes, legally you could. However, the possibilities of that happening are very remote. First Investors is an extremely solid company and it is one of the largest companies of the Principal Group. This certificate is backed by the assets of First Investors."

client: "The other places that I've been I haven't heard of Additional Credits. Why are you different?"

S/R: "First Investors is not a trust company. We do have a trust company under Principal Savings and Trust. First Investors is not eligible for Canada Deposit Insurance. *What we do instead to protect you is put your principal plus your 4% interest in reserve."* [Exhibit 248 at 54-5] [Emphasis added.]

Marlin testified that the Additional Credit Presentation was inaccurate insofar as it stated that principal plus 4% was on reserve. [13629-30]

Some investors testified that they were informed by their salesmen that the additional credits had always been paid by FIC and AIC. [239; 243; 267; 383; 1324; 1810] This was confirmed by the evidence of salesmen. [2278; 2497; 3992; 3313] One salesman testified:

> I would tell you that it pays a higher rate of return, including the additional credit, which is not guaranteed, and I guess that's one of the reasons why we have to pay you a higher rate. But in the 33 years of history, the company has never altered, reduced, or eliminated any of those additional credits. [2146]

In fact, that was not true. According to minutes of a meeting of the directors dated May 8, 1984 additional credits for certain FIC and AIC certificates previously declared earlier that year were cancelled from and after January 1, 1984 and no additional credits were to be credited to the accounts of such certificate holders until such time as quarterly additional credits on them were again declared. Neither the sales force nor the certificate holders affected were notified at that time, or at any time, of the cancellation. The affected certificate holders were deliberately selected as those who would not be entitled to receive any payments for the period involved. By directors' minutes dated June 29, 1984 the additional credits for the first and second quarters of 1984 were reinstated, on the basis that profits were realized during the second quarter of 1984. [Exhibit 390 at 3-4A and 12-4 and Exhibit 535 at 4-6 and 9-11] In fact, no profits were realized.

Marlin testified as follows with respect to the cancellation:

> Q But you will agree with me that the sales force was told, and the investors were told that the company -- the contract companies had never failed to declare additional credits, and to pay them throughout their history?
>
> A That is correct, yes.
>
> . . . . .
>
> Q . . . Was there any consideration given to tell the sales force, and thus, the investing public, that there was a change in posture of the Board; in other words that this event had occurred?
>
> A I don't recall any discussion on that point at the time we passed these resolutions. [12034-5]

The evidence tends to show that Marlin acted dishonestly and fraudulently in allowing the sales force to continue to represent that FIC and AIC had never failed to declare or pay additional credits when he knew that the representation was not true. Obviously, had there been any hint or suggestion to investors that additional credits might not be paid, they would not have purchased FIC and AIC products, since the "guaranteed" or fixed interest component was only 4%.

Some investors and salesmen testified that they understood that the source of additional credits was the profits of FIC and AIC or the Group. [239; 264; 383; 1324; 1637; 2278-9]

Senior management had a similar understanding. Mitchell said in testimony:

> I knew, in my own mind, that they were paid at the discretion of directors. It makes some sense that directors would pay for them out of profits. [5834]

Moulton testified:

> Well, according to the Investment Contract Act and the understanding that Don Cormie had provided to me at sales committee was that additional sales [sic] had to be declared at a profit. [4865]

Investors who purchased their FIC or AIC term certificates as RRSPs received a schedule signed by Marlin which formed part of the contract. It stated:

> Net profits of the Company may, from time to time, be allocated to this Certificate in the form of Addition Credits. Any allocation shall be at the absolute discretion of the Board of Directors of the Company. [Exhibit 386]

The Special Bulletins stated that:

> Due to continuing high interest rates, the Board of Directors continue to pass profits on to certificate holders as additional credits. [Exhibit 23]

As will be seen later in the Report, FIC and AIC did not earn a profit in 1984.

The 1985 Annual Review stated:

> . . . The Certificate Companies invest these monies, paying a basic guaranteed rate as well as "additional credits" or interest on these certificates at the discretion of the Directors based on market interests [sic] rates and company earnings. . . . [Exhibit 11]

The evidence tends to show that the purpose of the representation, which emanated from Donald Cormie and Marlin and was intended by them to be repeated by the sales force to investors, was to suggest that the payment of additional credits was a reflection of the profitability of FIC and AIC. In fact, as will be seen later in this Report, FIC and AIC were not profitable and additional credits were not paid out of profits but rather from new money coming into the Group. The evidence tends to show that the conduct of Donald Cormie and Marlin with respect to fostering this representation was fraudulent and dishonest.

Cross Selling and "Bait and Switch"

The sales force was trained to make individuals coming to PFCs as a result of advertising, walk-in business or otherwise, aware of the balanced portfolio concept and the full range of products offered by the Group. Marlin testified as to the strategy:

> Well, certainly the advertising was to bring the client in the door. The practice was that once the client was in the door then we attempted to find out the client's complete financial picture, if possible, and to improve the client's understanding of what a balanced portfolio might be like. We would go to some length to improve the client's understanding of a balanced investment portfolio. Very often, the initial product would be part of the package. If the client insisted that that is what they came to purchase, there is no question that is what they would be sold. [11696]

Much of the Group's print advertising was for PS&T term deposits. The advertisements offered attractive interest rates and made reference to CDIC coverage. The evidence tends to show that the purpose of such advertising was to get prospects in the door, not to sell them term deposits. Ritchie testified as follows:

> Q But the reason the ad was put in for the CDIC is that was a product that was known to the public, the term certificates were not, and the salesmen would then demonstrate the superiority, or at least the equal value of the term certificates?
>
> A Well, that, from my perspective, much of the task in marketing is, you know, to use a marketing term is customer gathering, and that means you have to speak to somebody, you know, to put your product in front of someone. And I don't think that there was -- there was never any talk of bait and switch the time that was there, I mean specifically saying, this is what we're going to do. It was more, is it making the telephone ring or people walking in the door.
>
> Q That's what you're trying to get is people in the door and what you found was the most effective was to advertise CDIC, a Principal Savings and Trust term deposit, which then gave your salesmen an opportunity to explain the value of the other products?
>
> A Yeah, over time that hadbeen found most effective. Certainly it obviously had worked before I arrived and it worked after too. [5144-5]

The evidence tends to show that PFCs had CDIC decals in the window. [16369-70] Upon entering a PFC, the prospect saw primarily PS&T marks on various materials. [13303-4] If the prospect asked about the purchase of a PS&T term deposit at the trust counter, he was referred by the PS&T teller to a "consultant", who was a PCL salesman. There was no explanation that the prospect was being referred to a PCL salesman nor was there any physical separation between the two operations in the PFC.

A number of investors testified that when they attended at PFCs in response to PS&T term deposit advertisements, they were given presentations with respect to mutual funds and FIC and AIC certificates. That this happened was confirmed by Aboussafy and others. [494-5; 3950; 9072-3; 9584-5; Exhibit 244 at 142] In the end, some purchased FIC and AIC term certificates instead of PS&T term deposits. [616-9; 159-64]

The evidence tends to show that the existence of the PFCs in combination with the practice of PS&T employees referring prospects to PCL salesmen confused at least some investors as to what product they had purchased and who they had contracted with. In some instances investors did not realize they had purchased FIC or AIC products rather than PS&T. [207-11; 178-9; 407-12; 1251-4] Both Marlin and John Cormie testified that they were aware of this problem. Marlin understood that people complained to the Alberta regulators that they were confused as to the product they purchased and who had offered it. He also said that the regulators approved the use of the "PFC" designation. [9627; 11896; 13304]

Contributing to the confusion was the fact that many investors in FIC and AIC products were told to make their cheques payable to "Principal Plans", "Principal Savings and Trust" or "Principal" instead of FIC or AIC, and interest on FIC and AIC certificates was paid into accounts opened with PS&T. Statements of account detailing FIC and AIC investments were entitled "Principal Group of Companies". [Exhibit 54; 431; 1678] Confirmation receipts referencing "Principal Group of Companies" were sent to purchasers of FIC and AIC products. [Exhibit 87]

Cross selling was defined by one member of PS&T management as:

> . . . the promotion, marketing and selling of one or more services to an existing client who is using one of our services to date. [Exhibit 360 at 10]

John Cormie testified that cross selling was a key component of any financial services group. [9052] Ritchie saw cross selling as an important factor in increasing sales in that it would hold the customer to the company. He explained that "the more relationships with the client, the more likely he is going to be with you over a period of time". [5054]

While cross selling is an accepted sales practice, "bait and switch" is not.

In correspondence dated October 31, 1986 [Exhibit 255 at 66], IFIC stated that it expected all its members, which included Marlin and others [9726; Exhibit 300 at 258], to comply with The Canadian Code of Advertising Standards which states as follows:

> Bait and Switch
>
> The consumer must be given a fair opportunity to purchase the goods or services offered at the terms presented. If supply of the sale item is limited, this should be mentioned in the advertisement. Refusal to show or demonstrate the product, disparagement of the advertised product by sales personnel, or demonstration of a product of superior quality are all illustrations of the "bait and switch" technique, which is a contravention of the Code. [Exhibit 255 at 71]

Ritchie acknowledged that the Code was understood within the Group. [5143] He testified that the Group's practices were not considered internally to be bait and switch techniques. However, the British Columbia regulators thought that they came close. In a letter dated September 12, 1983 from the Superintendent of Credit Unions, Co-operatives and Trust Companies to John Cormie it was stated that:

> It is quite obvious that your consultants are steering would-be clients of the Principal Group, against their wishes, into investment vehicles which are more beneficial to the salesperson's commission account, among other considerations. . . .
>
> • • • • •
>
> . . . but when it involves the substitution of the interests of the corporation and its servants for the interests of the client, in what falls a little short of a 'bait and switch' tactic, the practice is not acceptable. [Exhibit 362]

A similar concern had been raised earlier by the ASC in a letter to Marlin dated March 5, 1979 in relation to the advertisement of mutual funds:

> Failure to clearly emphasize the exact nature of the security and of the company offering it can lead to unfortunate results. It is my understanding that persons have been induced to contact the Principal Group of Companies through such advertising and have purchased securities emanating not from the company advertised but from other companies in the group; this type of advertising can lead an unsophisticated and careless investor to almost any product that Principal Group sells in a manner reminiscent of the "bait and switch" tactics that are sometimes found in the retail merchandise trade. [Exhibit 403 at 67B/C]

The evidence tends to show that the cross selling practices of the Group came close to and in some instances amounted to "bait and switch" tactics. The effect of the Group's practices was to blur distinctions between the companies in the Group, their products and their features, with the result that some investors did not know which company they contracted with or the nature of the product they purchased.

PGL Notes

The evidence tends to show that investors were misled with respect to the attributes of PGL promissory notes. The sources of the misrepresentations were Donald Cormie and James Cormie.

As part of Donald Cormie's strategy to increase the sale of PGL notes, a meeting of select salesmen was held in March, 1985 to discuss the PGL promissory note program, its expansion and the security for the notes. James Cormie took part by participating in a "role-playing exercise" whereby he gave a sales presentation with respect to PGL notes. Moulton took extensive notes of the presentation, had them typed up and presented them to James Cormie for verification. James Cormie and Donald Cormie both read the typed notes and made corrections. [Exhibit 252 at 437; 4623; 13867-70; 16755-62] The document was subsequently retyped, entitled "Observations Principal Group" and disseminated verbally to the sales force. [Exhibit 252 at 376]

The following statement was made therein by James Cormie, not edited out by either Donald Cormie or James Cormie, and passed on to the salesmen:

> The approximately 250 million dollars of mutual funds that are managed by Principal Group Ltd. generates 5 million dollars per year net of all expenses. The value of this stream of cash flow is at least 50 million dollars. None of this value is reflected on the company's books. Add this value to the companies net worth and you have, perhaps, one of the best capitalized financial institution [sic] in Canada. [Exhibit 252 at 376]

This statement was false. The mutual funds were managed by PSML, ownership of which had been transferred from PGL to CSL on August 15, 1984. Donald Cormie and James Cormie knew that the transfer had been completed and yet represented to the sales force that PSML and the assets managed thereby accrued to the benefit of PGL, knowing the sales force would pass such false representation to prospective purchasers, intending the latter to rely thereon. Moreover, the evidence tends to show that PGL was insolvent at the time and that Donald Cormie knew it. This is discussed elsewhere in the Report.

Other representations were made in a document entitled "Principal Group Corporate Notes Product Explanation" which was used by salesmen and given to investors. [Exhibit 221; 2955-6] This document was authored by Rick Mathes of the Operations Department. [4280; 4685; 5332] It appears to have had its source in the "Observations Principal Group" document; there are many similarities. The document was widely circulated in 1986 by both Moulton and Wallace in keeping with the Group's strategy to increase PGL note sales. The covering memorandum from Wallace dated August 25, 1986 stated in part that:

> This document explains the financial nature of PGL notes, the types of investments which are made with PGL Note money, and the benefits of PGL Notes to our clients. Many of you will be familiar with much of the information in this document, but I think you may

> find some new information in it which will be of use to you in answering questions from prospective clients. [Exhibit 179; 4280]

The document represented that PGL had assets of $1 billion, that the Group booked successive record profits in 1984 and 1985, and that numerous "off-balance sheet assets" added to the underlying value of the company.

None of these representations were true.

J. THE 1984 ANNUAL REPORT AND 1985 ANNUAL REVIEW

Reference has already been made to these documents and further reference will be made to them later in the Report. However, I wish to comment briefly as follows.

The evidence tends to show that these 2 documents were used to recruit and train the sales force and promote the Group and its products, including FIC and AIC term certificates and PGL promissory notes. [766; 772; 835; 4005; 505; 1225-6; 1311-2; 1450-1; 1455; 1936-7; 1948-9; 2269-70; 2717; 2767; 2784-6; 2814]

Marlin testified that both the Annual Report and the Annual Review were used for training. [11610; 11756; 12538-41; 12548; and 12896] Donald Cormie and Marlin acknowledged that the Annual Report and the Annual Review would be distributed to clients or otherwise used for the purpose of promoting the Group and its products. [11700-02; 11707; 11758; 12538; 12548; 12553; 12555; 12896-7; 13144; 13624; 13471-2; 16645-8; 16691; 18795-6; 18812-4; 20054-5]

The 1984 Annual Report

The 1984 Annual Report referred to 1984 as "our best year ever". Donald Cormie's Chairman's Perspective spoke of "an outstanding performance by Principal in 1984" and a "record high" net profit of $4,418,000 representing a "fourfold increase from a profit of $799,000 in 1983, a year in which special reserves for mortgages and owned real estate were established". With respect to FIC and AIC, the Annual Report stated that "First Investors had an excellent year in 1984" and that AIC earned a profit of $117,888 in 1984.

As will be discussed later in the Report, the evidence shows that were it not for a change in valuation of owned properties, PGL would have sustained a loss in 1984 of over $1,000,000. The evidence also shows that were it not for aggressive accounting practices with respect to writedowns on mortgages and owned properties, FIC and AIC would have incurred losses in 1984. These matters were not brought to the reader's attention.

Note 1 to the audited consolidated financial statements of PGL, which listed the subsidiaries included in the consolidation, did not list PSML as it was no longer a subsidiary as at December 31, 1984. Nowhere else in the Annual Report, however, was it disclosed that the ownership of PSML was transferred to CSL. References to the mutual funds implied that PSML continued to be a subsidiary. Under the heading "Financial Highlights", the total assets under administration of $895,685 was shown to be comprised of $642,791,000 Balance Sheet Assets and $252,894,000 Managed Assets. The Managed Assets were administered by PSML after August 15, 1984. The evidence tends to show that the references to PSML were deliberately included by Donald Cormie to imply that it and its managed assets were part of PGL and the Group. That was not the case. The evidence tends to show that such conduct was dishonest and fraudulent.

The 1985 Annual Review

Donald Cormie testified:

> Q MR. WHITE: Now, in an effort to speed this thing up, Mr. Cormie, I just am going to ask you about Exhibit 11, whether there is anything in there which you, sir, consider to be false or misleading?

A Well, I haven't even to this day read the thing through in detail. I — so I can't say whether there is anything false. But nothing that I have read or that I have observed. [21575]

Marlin testified:

Q Now, then, back to Exhibit Number 11, Mr. Marlin, the Annual Review for 1985, do you adopt and approve of what's in there, sir?

A Do I adopt and approve?

Q What's in there.

A There is certainly things that could have been said better, but generally I approve. [13469-70]

• • • • •

Q Do you consider, sir, that there is anything in there which is misleading?

A I don't see anything that's misleading, seriously misleading. I suppose it's possible to interpret, in certain ways, things that would be misleading. But I generally feel it is well done and not misleading to the public. [13470]

Notwithstanding Donald Cormie's evidence that he did not see or approve of the Annual Review, but was only involved in drafting and editing certain sections which were later revised [16647-8; 16650-7; 16664-6; 16692-3; 18796], the evidence tends to show that Donald Cormie reviewed and approved the final proof. [11765-6] Further, his name is on the Annual Review and he signed it.

The evidence tends to show that the 1985 Annual Review was misleading and contained a number of false representations.

In his Chairman's Message, which he authorized [16672], Donald Cormie stated that:

> 1985 was another outstanding year for Principal Group. In 1984, despite the overall weaknesses in the financial sector in Canada, we announced record profits of $4.4 million. In 1985 additional reserves in some of our subsidiaries reduced our profits to $607,000. For the first time, group assets under management exceeded $1 billion at year end, currently exceed $1.2 billion, and we anticipate will reach $4 billion by 1990 as our expansion continues.

The evidence tends to show that the statement about 1985 profits was misleading.

The decision to publish an Annual Review instead of an Annual Report was made after the 1985 year end audit had been completed. [19657] The 1985 audited statements were qualified and when adjusted to comply with GAAP showed a loss of $25.7 million for PGL consolidated. Both Donald Cormie and Marlin acknowledged that the qualified audited statement was a factor in the decision not to publish an Annual Report. [11759; 16663] The evidence tends to show that it was the sole reason and that the Annual Review concept was adopted in order to avoid the publication of the qualified audited PGL consolidated financial statements.

Pages 40 and 41 presented a 10 year review of the Group. It represented that PGL had a profit for 1985 in the amount of $607,000, but such profit was the subject of a qualified audit while the figures for the other nine years were the subject of unqualified audit opinions done according to GAAP.

The evidence of McCutchen of Deloitte Haskins & Sells, the auditors of PGL and its subsidiaries after 1983, was that in April or May of 1986 he attended at meetings with Donald Cormie and others at which the necessity and desirability of publishing an Annual Report for 1985 was discussed. At that time McCutchen was firm that Deloitte Haskins & Sells would be issuing a qualified audit opinion, and there was discussion that such an opinion published in an Annual Report would not present a very favourable picture of the Group. [24773-5]

When McCutchen became aware of and read the Annual Review after its publication he told Donald Cormie that it contained financial information, such as the reference to consolidated net income of $607,000, with which he disagreed and which was not in accordance with the qualified audit opinion. He could not recall Donald Cormie's response to his advice. [24776-8]

Donald Cormie testified that he approved the figures in the Chairman's Message and knew that the $607,000 figure was as a result of a qualified audit. [16676] The evidence tends to show that his conduct in allowing the figure to be used was fraudulent and dishonest, as he knew or should have known that it was seriously misleading.

No distinction was made in the Annual Review among the members of the Group. Nowhere in the Annual Review was there a breakdown among and between the various corporate entities as to individual asset ownership. No distinction was made between PGL's balance sheet assets and the assets in respect of which they provided administrative functions or computer assistance. The "coin" in the Annual Review illustrated "Distribution of Assets Under Administration". To the extent that the coin included the mutual funds as "assets under administration", it was a false representation because by 1985 the mutual funds were being administered or managed by PSML, which was no longer part of the Group.

With respect to the reference in his Chairman's Message about moving out of real estate, Donald Cormie testified:

> Q Unfortunately, your statement is, "Our success in moving out of real estate in advance of its subsequent collapse and moving into the stock and bond market at its low points." Why didn't you say and moving into the mortgage market?
>
> A Well, I think in retrospect, looking at it, it probably would have been a useful addition. [21362]

The Chairman's Message also made reference to the oft-quoted "cycle theory". Donald Cormie testified:

> Q In the third paragraph you write, "This accomplishment is not merely luck. Principal Group manages our clients' investments and our corporate portfolios using in-depth analysis of long-term cycles and trends within the economy. By understanding these trends, we have been able to act rather than react." Do you, then, sir, say that that statement by you required elaboration and explanation?
>
> A Yes, I'm not happy with it completely. I think it would have been better if it would have been more — explained more fully. [21358]

The evidence tends to show that the omission of any reference to mortgages and the reference to "act rather than react" were deliberate and intended to deceive the reader into believing that Principal was out of real estate and mortgages and had not been adversely affected by the real estate collapse. The evidence tends to show that this conduct was fraudulent and dishonest.

K. CONCLUSIONS

The evidence tends to show that the sales objective of Donald Cormie and the Group at all times was to increase the money coming into the Group, although at various times emphasis was placed on the sale of particular products. After 1978 the sale of FIC and AIC single pay or term certificates rather than accumulation plans was emphasized. In 1984 Donald Cormie directed that the sale of mutual funds be emphasized in order to attain a 4 to 1 ratio of mutual funds to "guaranteed" products. He continued, however, to direct that the sales of FIC and AIC term certificates be increased. From 1985, Donald Cormie directed that sales of PGL promissory notes be increased.

The evidence tends to show that increasing the flow of funds into the Group became critically important once the impact of the real estate collapse was felt. New money in was the source of funds with which to pay maturing obligations in the absence of revenues from mortgages and other assets.

At the direction of Marlin, the emphasis by the sales force in selling FIC and AIC term certificates was on the "government protections" required by the *ICA*, protections that made such investments safe and secure and made CDIC unnecessary. Such protections were particularly attractive to investors after the problems encountered by the credit unions and Dial Mortgage and the failure of CCB and Northland. The evidence tends to show that the deliberate linking of the safety and security of investments in FIC and AIC with the regulatory requirements of the *ICA* was in breach of s. 46 of the *ICA*.

The primary "protection" emphasized was the requirement of assets on deposit. Using product information emanating from or approved by Marlin, the sales force represented to the public that assets equal to 100% of certificate liabilities were required to be on deposit with a custodian. To Marlin's knowledge, the sales force understood and were representing to investors that principal or principal plus 4% was on deposit with the custodian. It was not on deposit. The evidence tends to show that Marlin acted fraudulently and dishonestly in permitting and encouraging the sales force to make the representation when he knew it was not true.

Representations in respect of the nature and quality of the assets of FIC and AIC and the Group and the financial strength of the Group were also made. The evidence tends to show that these representations, which emanated from Donald Cormie and Marlin and which they knew were not true, were intended by them to be relied on by investors. The evidence tends to show that their conduct in that regard was fraudulent and dishonest.

The evidence tends to show that to the knowledge of at least Donald Cormie and Marlin, the sales force was selling FIC and AIC term certificates to the public when those companies were no longer viable and indeed, were insolvent. By April of 1987 the submission requesting Government financial aid was being prepared. The starting premise of the submission was that FIC and AIC were no longer viable. Yet Donald Cormie and Marlin permitted the continued sale of FIC and AIC products. In the case of Donald Cormie, his evidence confirms that to his knowledge FIC and AIC were in much better shape in 1987 than they were in 1984 [18542-3; 19137], from which I take that he knew in 1984 that the companies were not viable. He took no steps to halt the sale of FIC and AIC products. Rather, the evidence tends to show that he deliberately permitted the companies to carry on while he took steps to disguise their true financial situation. This will be discussed later in the Report. The evidence tends to show that the conduct of Donald Cormie and Marlin in permitting the sale of FIC and AIC products when they knew the companies were no longer viable was both dishonest and fraudulent.

As will be noted in the section on the post 1983 years, the evidence tends to show a grand plan to cover up the problems FIC, AIC and PGL had encountered. As can be seen from the foregoing, both Donald Cormie and Marlin, through their involvement in sales and marketing, perpetuated the "disinformation" that these three companies, and indeed the Group, were not only healthy but facing a bright future. Much of the foregoing activity has been found to be evidence tending to show fraudulent or dishonest conduct and therefore I have reported it. The post 1983 activity in its entirety is evidence tending to show the grand plan.

The evidence tends to show that very little of the instructional and promotional materials used in connection with the selling of FIC and AIC products was submitted to or approved by the Alberta regulators as required under the *ICA*. The evidence tends to show that this omission was a deliberate breach of the *ICA* by Marlin.

V. MONEY-OUT

A. INTRODUCTION

The "Money-Out" function was defined in testimony during the public hearings as "the Investment Department, Control Department, Accounting, Computers and Legal". [11576] The terminology was used in-house at PGL and related to PGL as a whole in a functional sense, crossing all corporate boundaries. [13407-8]

The major component of the money-out function involved investment, which was performed by the Investment Committee and the Investment Department.

This chapter of the Report also deals with intercompany service and management agreements, distribution agreements, administrative fees and levies as well as loans and transactions with the so-called "upstairs" companies, i.e., CSL and CSI (PGL's parent) and other affiliates or related corporate entities. All of this activity pertains to the money-out function.

B. ADMINISTRATIVE FEES AND LEVIES AND TRANSACTIONS WITH "UPSTAIRS" COMPANIES

Pursuant to the functional organization of the Group, service and management agreements were entered into between member companies pertaining to administration, management, and investment.

1. Service and Management Agreements

The service agreement between AIC and PGL [Exhibit 435 at 8] dated January 1, 1975 and the service agreement between FIC and PGL of the same date [Exhibit 435 at 59] are virtually identical. Under these agreements FIC and AIC retained PGL as a service company to provide administrative, accounting and advisory services including advice, statistical data and recommendations as were necessary or convenient for FIC or AIC to carry on its business.

The basis of the calculation of fees payable under the service agreement is divided into matters relating to mortgages, investment contracts, securities transactions, real estate and general.

For mortgages, there was a placement fee according to a percentage of the loan as well as an annual administration or service fee. For investment contracts, the fee was $2 per month per account, payable to provide complete administration of certificate accounts, all of which was defined in the agreement. A service fee of ⅓ of 1% per annum of the value of all securities held, ⅝ of 1% per annum of the net book value of real estate held, and ⅝ of 1% per annum of the principal balance of the mortgages outstanding was payable to PGL. There was also provision for the payment of salaries of PGL employees.

The agreement between PS&T and PGL [Exhibit 435 at 146] was styled as Management Agreement but was in generally the same terms as the service agreements between FIC and AIC and PGL. Rather than referring to investment contracts, this agreement refers to guaranteed investment certificates.

Pursuant to the Administrative Services Agreement between PSML and PGL dated August 14, 1986 [Exhibit 435 at 132] PGL agreed to provide administrative services to PSML according to a formula calculated on the basis of ⅙ of 1% times the total asset value of all mutual funds and private accounts, times the working days per month divided by the working days per year. This fee was payable monthly.

By an agreement entitled Private Account Management Agreement and dated August 14, 1986 [Exhibit 450], PSML contracted with PGL to provide investment services to PGL for private accounts, the private accounts being defined as those parties, namely PS&T, FIC and AIC, to which PGL provided administrative, accounting and advisory services pursuant to various service agreements referenced above. The fee payable to PSML is calculated as ½ of 1% times the total average asset cost, which is the average asset cost of the securities in private accounts in any given month, times the working days per month divided by the working days per year. This fee was payable monthly.

By way of example, assume that the entire proceeds of the sale of an investment contract of $100,000 sold by FIC or AIC was invested in a security after August 14, 1986 (as opposed to a mortgage loan). The annual fees generated by these various agreements were as follows:

(a) Pursuant to the service agreement, PGL would receive $2 per month or $24 per year from the investment contract company.

(b) Also pursuant to the service agreement, PGL would receive $333, being ⅓ of 1% per annum of the value of the security, from the investment contract company.

(c) Pursuant to the Administrative Services Agreement, PSML would pay PGL $166, being ⅙ of 1% of the value of the security.

(d) Pursuant to the Private Account Management Agreement, PSML would receive $500 from PGL, being ½ of 1% of the value of the security.

Based on this example, the net effect of the transactions is that PSML receives $334 (being the $500 it received from PGL less the $166 it pays PGL); PGL receives $23, (being the net PGL receives after receiving $357 from the investment contract company and paying PSML the net amount of $334).

It is clear from the above-described agreements that the fees payable thereunder, except for the initial mortgage placement fee, continue periodically so long as the account or asset exists. They are continuing fees based on the value of the assets being administered and have nothing to do with selling or distribution or the revenue derived therefrom. The administrative fees paid by FIC and AIC pursuant to the service agreements referred to above were called "administrative fees" or simply "levies" in the evidence, and are so referred to in this Report. These levies were charged for only part of the year in 1983. They were partially waived or forgiven in 1984 and fully waived or forgiven in 1985 and 1986, as outlined elsewhere in this Report.

The quantum of these levies is included in schedules to the audited financial statements of FIC and AIC entitled "Schedule of Sales Certificate Issuance and Administrative Expenses". The FIC audited financial statements for the year ended December 31, 1981 [Exhibit 272 at 81] show administrative services for FIC as an expense of $2,309,551. The FIC amount for 1982 [Exhibit 272 at 73] is $2,[illegible]64,622 and for 1983 [Exhibit 272 at 61] is $1,655,864. In subsequent years, the administrative fees decrease so that by 1985 when the fees were totally forgiven, they are shown as being non-existent. In a note to the 1985 FIC financial statements [Exhibit 272 at 26] it is indicated that $3,482,174 of administration fees were forgiven in 1985 and that $2,758,218 of administration fees were forgiven in 1984. According to Note 13 the financial statements for the year ended 1986 (in draft) [Exhibit 272 at 12] in 1986 $3,299,684 was forgiven FIC. According to Exhibit 623, administrative fees and levies minus any that were forgiven amounted to $54,530,886 from 1979 through 1986 for FIC and AIC.

A schedule prepared by Johnson [the last two pages of Exhibit 283, Transaction #7] show the total levies paid by FIC and AIC during the period 1981 through June 30, 1987. The amounts reversed or forgiven are also included. Johnson did a calculation of the amount of the levy as a percent of the average assets, which percentage decreased from 1981 to 1984, inclusive. Some amounts were forgiven in 1984. The highest yearly percentage was 1.47% in 1981 and the lowest in a year without forgiveness was .61%. The levies were paid in advance at the beginning of each month.

The levies charged to FIC and AIC are set out in Exhibit 436 at 1 and 2 respectively. The 1982 figure for the actual levy is the same as in Johnson's schedule attached to Exhibit 283 referred to above. The 1983 net figure is the same, but according to Exhibit 436 the 1983 figure is net of waived or forgiven levies. Another source of the quantum of the levy before waiver is the exhibit prepared for and on behalf of Allan, the Trustee in Bankruptcy of PGL. [Exhibit 611 at 49 and 50] The amounts paid in levies between 1979 and 1981 are set forth in Exhibit 257 at 163. A compilation of the amounts is set forth on Table 2 of Mr. White's argument at T-11.

2. Surplus/Term Surplus — Distribution Agreements

Description

The distribution agreements pertain to the selling of the products and the money generated by the sale. FIC and AIC each had distribution agreements with PCL. [Exhibit 435 at 1 and 37 respectively] By the terms of the distribution agreements PCL agreed to offer for sale and distribute investment contracts issued by FIC and AIC. PCL was to be paid fees or commissions in accordance with the schedules put out from time to time by FIC and AIC. Counsel for the Cormie family submitted that the fees or commissions in accordance with schedules put out from time to time by FIC and AIC are embodied in the document tendered as Exhibit 469.

Exhibit 469 is entitled "Principal Consultants Ltd. Commission and Override Schedule June, 1983". The second page of Exhibit 469 is in the same format dated January, 1984 and contains the notations "OK, Donald Cormie" and "OK, KN Marlin".

An excerpt from Exhibit 258, beginning at 257 references the 5-year profit plans presented to the government in June, 1987. Among those references is a statement at the bottom of 262 which says:

> Commission structure
>
> on all sales, commissions and overrides are paid which are taken out of the acquisition fee (in the case of the mutual funds) or the difference between cash paid in by the customer and the statutory reserve required (in the case of FIC/AIC term certificates, or set up as a deferred expense PST term deposits). The structure is as follows:

Thereafter, at 263, the statutory reserve requirements for an FIC/AIC term certificate of $1,000 for one year is set out, showing that the reserve rate allowed is 6%, the guaranteed or fixed rate is 4% and thus, $1,040 is required to be paid out at the end of 1 year. The sum invested at the beginning of the year which will accumulate at 6% for one year to yield $1,040 is $981.13. Therefore, it is stated that "$1,000 minus $981.13 equals $18.87 which can be distributed . . . ".

The above is a calculation of the arithmetic difference between the amount actually invested by the purchaser of an investment contract and the amount which, if invested at the statutory reserve rate over the term of the contract, would yield the fixed or guaranteed rate due to the purchaser of the investment contract on maturity of the contract, i.e., 4%. This latter amount I refer to as the "reserve amount".

The example given at 263 of Exhibit 258 is:

	$1,000, 1-year FIC Term
Consultant	$ 2.25
Sales managers	0.95
Administration (PGL)	5.20
Agency (PST)	0.10
Head Office Sales (PCL)	0.50
Subtotal	$ 9.00
Surplus (PGL)	9.87
Total	$18.87

The difference between the face amount of the investment contract, $1,000 in the example above, and the reserve amount of $981.13 was called in the evidence the acquisition cost or the acquisition fee and in Mr. Duke's submission, on behalf of Donald Cormie, James Cormie and John Cormie, the distribution fee or the distribution cost.

It is properly speaking neither an acquisition nor a distribution cost. It is a maximum amount *available* to be paid as a distribution fee or an acquisition fee, because it is not required for the reserve amount.

In the above example, in the first instance, the entire $1,000 paid by the purchaser of the investment contract was owned by FIC or AIC. What FIC and AIC agreed to pay as commissions or distribution fees respecting the sale of investment contracts is not directly governed by the *ICA*. In the example above there was no contractual obligation to spend $18.87 on distribution fees or costs.

It is clear that the total money available for distribution fees or costs was expended by FIC and AIC at all times. Neither the contractual arrangements FIC and AIC made with PCL nor the actual selling costs justified these payments.

If FIC and AIC chose to contract with an agent or distributor for the purpose of selling the product, which they did, the quantum of the payment for such distribution or sale is properly a subject of the agreement, which it was. The distribution agreements do not directly deal with the quantum of the payment to PCL. Nowhere in the distribution agreements does it indicate that the difference between the face amount of the investment contract and the reserve amount, $18.87 in the example above, is the acquisition or distribution fee payable to PCL. The evidence does not tend to show that the acquisition or distribution fee of $18.87 or any similar number based on that formula was agreed to by FIC or AIC.

PCL was paid $6.12 of the $18.87. [Exhibit 469] This is the amount shown paid under the heading "distributor". Of the categories shown in Exhibit 469, PS&T received "agency"; PCL, or the sales people received "consultant", "sales managers", "head office sales" and "Levels 1, 2, 3"; PGL received "administration", including "marketing" and "advertising". There does not appear to be any agreement between PCL and PGL entitling PGL to any sums upon the sale of an investment contract by PCL. According to the evidence, PCL is the "sales arm" of PGL. Whether or not the schedules set forth in Exhibit 469 are in fact the schedules referred to in the distribution agreements as submitted by counsel for the Cormie family, the fact remains that the schedules purport to allocate the so-called acquisition cost or acquisition fee among various corporations in addition to PCL.

FIC and AIC gave up the entire purported acquisition cost or fee, $18.87 in the above example. They agreed pursuant to the distribution agreements to pay to PCL fees or commissions in accordance with schedules put out from time to time by FIC or AIC. There were no such schedules. Exhibit 469 is a PCL schedule, not an FIC or AIC schedule.

The other significant covenant of FIC and AIC in the distribution agreements was to pay all fees and disbursements and expenses of PCL in connection with its registration, licensing or qualification as a broker, all commissions and expenses paid to its salesmen or sales representatives, all advertising and clerical costs including accounting and audit with respect to the offering for sale of investment contracts.

If Exhibit 469 is to be taken as evidence of the costs of PCL for which they were entitled to be reimbursed pursuant to the distribution agreements, under the categories of commissions, expenses, advertising, marketing and administration, one is left with the conclusion that the costs payable under the distribution agreements total only $9.00. The $9.87 in the example is, by definition, what is left over. It appears in Exhibit 469 and Exhibit 258 at 263 under the heading "surplus".

The evidence on the disposition of the "surplus" taken as a whole is that there was no agreement that the surplus would go to PGL. The "surplus" was treated as current income to PGL. In FIC and AIC it was treated as a deferred selling expense amortized over the life of the investment contract.

Exhibit 300 at 292, part of a submission to the government and entitled "Intercorporate Expenses/Revenues" indicates with respect to "surplus":

> Purpose:
>
> PGL historically financed the salesforce and recovers through this account the compensation for the historical financing. PGL is given a portion of the term certificate "commission". In PGL this is a current income item and in FIC/AIC it is a deferred expense amortized over the life of the term certificate. Based on a "reserve" allowed by government.
>
> Formal agreement: None.

Among the products of the Group, only the sales of FIC and AIC investment contracts generated the "surplus". [16477]

The amount of "surplus" paid in 1981 through 1987 to PGL is set forth in the last two pages of Exhibit 283, Transaction #7. The "surplus" was never the subject of a waiver or reversal and such money was always received in cash as income to PGL.

In Exhibit 469, there is no column for "surplus" in respect of mutual funds or PS&T guaranteed investment certificates, the income averaging annuity contract or the Principal accumulation certificate. Nor is there any indication that "surplus" should go to PGL.

The "surplus" is therefore a category of income to PGL created as the result of the sale of an FIC or AIC term product. It is a component of distribution or selling income at the time of sale and has nothing to do with the on-going administration or maintenance of the investment contract or term product after its sale.

No satisfactory explanation was given in the evidence as to why the "surplus" was paid to PGL. Donald Cormie said it went to PGL as a matter of policy; "we have no agreement". [19483] Donald Cormie attempted to justify the payment of the "surplus" to PGL "because it was just part of the administrative costs going to PGL". [19484] No satisfactory explanation was given of which administrative costs were supposed to be covered. Service agreements referred to earlier in this Report relating to the "administration" by PGL resulted in payment being made pursuant to those agreements. Later Donald Cormie said that PGL was to get the "surplus" money whether it costs that much or not. [19497] The "surplus" paid by FIC and AIC to PGL from 1981 through 1986 was $20,869,254. [Exhibit 623]

Effect of FIC and AIC Paying Term Surplus to PGL

Exhibit 623 shows the amounts by year of term "surplus" paid from 1981 through 1986. When one adds those amounts to the combined net income before tax of FIC and AIC for those years, the addition of the "surplus" into the net income before tax makes a marked difference as shown in Table 1 below.

TABLE 1

Source: Exhibits 272, 273, 623

	FIC/AIC N.I.B.T.	SURPLUS	TOTAL
1981	789,565	2,545,920	3,335,485
1982	(5,756,882)	3,314,047	[illegible]2,442,835)
1983	(138,461)	2,486,126	[illegible],347,665
1984	1,158,016	4,070,489	5,228,505
1985	(11,111,252)	4,501,670	(6,609,582)
1986	(27,746,592)	3,951,002	(23,795,590)

"Surplus" was paid during 1987 in the amount of $2,338,456. [Exhibit 611 at 49-50] The total "surplus" for the period of $20,869,254 ($23,207,710 when 1987 payments are included) does not take into account any income or asset gain that should have been realized had the money been kept in the investment contract companies and properly invested. It is reasonable to expect a significant return on investment during this time frame. Had the money been invested in stocks and convertible bonds, the expected return would be between 18% and 22% per annum according to James Cormie. [Exhibit 409 at 20]

Any prediction of the effect on the long-term viability of FIC and AIC had the "surplus" not been paid out to PGL is necessarily fraught with difficulty in that numerous assumptions would have to be made. However, Table 1 demonstrates a significant impact on profits before tax.

The evidence tends to show that the transfer by FIC and AIC of the "surplus" to PGL had a significant adverse impact on the cash outflow and on net income before taxes in FIC and AIC. In the result FIC and AIC were left vulnerable to the collapse of the real estate market and the Western Canadian economy.

3. Department 8 — "Upstairs"

There were many sources of funds available to Principal Group. Money available to the Group included the proceeds of the sale of investment contracts by FIC and AIC, PS&T guaranteed investment certificate sales and deposits, and the sale of PGL promissory notes. As well, the sale of mutual funds and administration and investment management of all products generated significant revenues as detailed elsewhere in this chapter.

"Department 8" was a separate division of PGL which administered the PGL investment portfolio [5273] through affiliates of PGL such as CSL and CSI. It also administered senior executive salaries [6990] and was physically located "upstairs" at PGL in Principal Plaza, Edmonton. [5469] In addition the term "upstairs" denoted the movement of money from the PGL Department 8 "upstairs" fund to CSL or CSI, the parent of PGL, and to other related entities, the "upstairs companies". [Exhibit 305] In the first instance the flow of funds was to CSL or CSI depending on whether the immediate parent of PGL at the time was CSL or CSI. On September 1, 1985 CSI became the parent of PGL whereas prior to September 1, 1985 CSL was the parent of PGL.

The "upstairs" fund was often sourced by gains on the sale of securities and the proceeds of promissory note sales transferred from the PGL note fund, or the "downstairs" fund.

The "upstairs" fund and the intercorporate loans made from that fund are important in analyzing the reasons for the financial failure of FIC and AIC. According to Exhibit 611 at 21, which was based on the draft 1986 PGL financial statements, on December 31, 1986 PGL was owed $67,359,078 by CSI. A schedule prepared by Stefanski [Exhibit 426 at 120] reported the balance as $66,598,596 while her Exhibit 428 shows $67,383,561. The difference is accrued interest. [Exhibit 337 at 23]

The nature and extent of these loans, how they were created, for what purpose and at what interest was largely the subject of the evidence given by Stefanski in conjunction with Exhibits 337, 338, 426 and 427.

The following conclusions can be drawn from the evidence:

(i) Money generated through the sale of PGL promissory notes was represented as being used for the "general corporate purposes of Principal Group Ltd." [Information Memorandum, Exhibit 187 at 4; Exhibit 441 at 62]

The evidence of Stefanski presented diagramatically in Exhibits 337 and 426, together with the computer sheets, Exhibits 338 and 427, clearly demonstrates that much of the money borrowed by PGL directly from the public pursuant to promissory notes went from downstairs (the PGL note account) to "upstairs" (the upstairs account), and thereafter was lent by PGL to CSL or CSI. The interest rate would be notched up by ⅛ of 1% over that which was being paid to the promissory noteholder. CSL or CSI would usually then immediately lend all or part of the sum to CIL, CRL or another affiliate.

(ii) PGL promissory note money was also the source of loans "upstairs" through CSL to CIL to members of the Cormie family for the purposes of individual family members' investments in mutual funds, RRSP contributions and payment of income and property taxes.

(iii) Many of the loan transactions were for "rolldown" purposes, i.e., to replace old loans with new loans at lower interest rates. That is to say, when the prevailing interest rate dropped, the promissory notes sold to the public carried a lower interest rate. The lower rate money was then lent up at the promissory note rate, plus ⅛ of 1%, and in so doing, replaced an older higher interest rate loan with a new lower interest rate loan. In the result, the rate of return to PGL was lessened and the cost of funds to CSL/CSI and other related and affiliated companies such as CRL, CIL and the Cormie family members was lowered.

Put in another way, the practice of "rolldown" was to lower the cost of money to the upstairs holding company, CIL, and ultimately to the Cormie family members at the expense of PGL, with a resultant unfavourable impact on profitability.

The evidence is that none of these loans from the PGL note fund was ever made interest-free; similarly the evidence is that none of these loans was ever documented with promissory notes or other written agreements. The documentary evidence consists of accounting records only. Thus the loans had no term, and thus no element of matching to the rate or the term of the original liability evidenced by the PGL promissory note.

(iv) Many of the loan transactions were done at or near year end to make sure the loans among and between affiliated and related companies were repaid within 1 year. In effect, however, they were usually replacing old loans with new loans before year end.

(v) Beginning on August 15, 1984, after the transfer of PSML to CSL from PGL, there was a concerted effort to replace interest-bearing loans owing by CRL to CSL with non-interest bearing loans. Non-interest bearing loans were financed by fees received by PSML and paid to CSL. Thereafter CSL split the fee with PGL.

Stefanski's diagrammatic evidence is concise and clear, demonstrating the above conclusions, and is fully supported by her testimony.

The evidence tends to show that PGL took money from the public and invested it in affiliates to the advantage of the affiliates and the Cormie family, and to the detriment of PGL. PGL did not put the money out at the best possible return so as to ensure its viability of over the long run. According to the evidence of Allan, PGL was "arguably bankrupt" by the end of 1983. [Exhibit 611]

Exhibit 428, prepared by Stefanski, shows the nexus. The loan balances for each company and the debtor-creditor relationship is shown on a year end basis from December 31, 1980 to December 31, 1986, as well as the balance as at August 31, 1987.

As at August 31, 1987 CSI owed PGL $64,560,623. PGL owed AHL $1,605,565. CSL owed CSI $33,364,856. CSI owed AHL $1,635,565. CRL owed CSL $12,471,081. CIL owed CSL $6,912,265. The Cormie family members as a group were indebted to CIL in various amounts totalling $10,875,822. Each of the family members was owed money by CIL, in various amounts, but the net Cormie family loans owed by the family as a group to CIL amounted to $6,784,011 (the vast majority of which was attributable to Donald Cormie and his wife, Eivor E. Cormie). [Exhibit 428] The prepaid interest accounts of CIL held by the Cormie family members as set forth in Exhibit 428 represented "deposits" or credits maintained by members of the Cormie family with CIL. These prepaid interest accounts were from time to time during the period December 31, 1980 through August 31, 1987 in the names of Donald Cormie, Eivor E. Cormie, John Cormie, James Cormie, Allison Cormie, Neil Cormie, Don Cormie, Jr., Bruce Cormie, Eivor Cormie, Jr. and Robert Cormie.

The loan from PGL to CSL stood at $15,709,208 in 1983. The balance grew dramatically in years following. It has been argued that most of the increase was attributable to intercorporate trans actions, rather than funds taken for personal purposes. Accordingly I shall describe that evidence.

The PGL trustee in bankruptcy, Allan, reconciled the balance of the loan as follows: [Exhibit 611 at 95]

Advances to CSL, December 31, 1983		$15,709,208
1984 Advances (net)	3,554,370	
1985 Advances (net)	4,622,980	
1986 Repayments (net)	(5,451,633)	
1987 Repayments (net)	(5,441,311)	
Net Repayments		$ (2,715,594)
Net Advances (unreconciled)		$12,993,614
Advances arising from intercompany transactions		
# 2	$12,500,000	
#12	12,932,954	
#16 and #17	15,991,199	
#10	10,000,000	
	$51,424,153	51,424,153
Advances to CSI, August 10, 1987		$64,417,767

Of the 1985 advances, $3,367,455 related to the PMF transaction. [Exhibit 419; Exhibit 426 at 29, 133] That money, according to Exhibit 426, was paid to Levesque on December 16, 1985, the date of purchase of the bonds destined for PMF. The payment was recorded as "re Multiplier Fund" and explained in Exhibit 426 at 133 as "Purchase of Government of Canada Bonds not sold on Principal Multiplier offering". Thus the amount of unreconciled advances (those that cannot be attributed to a known intercorporate transaction) are $9,626,159, or stating it another way, $54,791,608 of the loan balance represented identified intercorporate dealings.

Evidence was also given by Stefanski as to the composition of the loan. It is helpful to set it out here. Records produced by Stefanski [Exhibit 426 at 120] with respect to the loan from PGL to CSL and CSI show:

	Balance	Change
December 31, 1979	$ 2,174,964	—
December 31, 1980	9,659,523	$ 7,484,559
December 31, 1981	18,260,464	8,600,941
December 31, 1982	21,661,327	3,400,863
December 31, 1983	15,395,827	(6,265,500)
December 31, 1984	31,785,426	16,389,559
December 31, 1985	36,589,676	4,804,250
December 31, 1986	66,598,596	30,008,920

The figures in Exhibit 426 at 120 vary somewhat from those stated in the audited financial statements of PGL, as well as from those stated in Exhibit 428.

The transactions giving rise to the increase in the loan balance for the year 1986 are as follows:

(1) Exchange of PNI shares for Promissory Note: June 6, 1986 (non-cash)	$12,932,954	
(2) East/West #1: Dec. 30, 86	2,500,000	
(3) Transaction #16: Nov. 20, 86	8,800,000	
(4) Transaction #17: Dec. 24, 86	7,995,499	
Mutual fund loans	201,300	
	$32,429,753	
Payments back (net)	2,420,833	
	30,008,920	$30,008,920
Non-cash item (PNI Share Transfer)		(12,932,954)
(5) Received by PGL. Sale of Matrix shares; Transaction #16	7,995,700	
(5) Received by PGL. Sale of Matrix shares; Transaction #17	7,995,499	
Received by FIC. Transaction #10	7,500,000	
Receipts of cash	($23,491,199)	(23,491,199)
Cash received component		$6,415,233

(1) See Transaction #12.

(2) See Transaction #10. East/West #1 was funded from PGL's "downstairs" resources. East/West #2 was funded by CSI from the sale of mutual funds, while the advance to 356539 Alberta Ltd. was funded from a Levesque account in the name of CSI. [Exhibit 426 at 39]

(3) Funded from PGL's "downstairs" resources, then lent to CSI, then AHL, who paid it to Levesque for deposit in the CSI bond account.

(4) Funded from a Levesque account in the name of PGL. PGL lent the money to CSI, who paid it to Levesque for the purchase of bonds to secure the put and call obligations.

(5) See Transactions #16 and #17, elsewhere in this Report.

[Exhibit 426 at 121-4, 133]

There also exists for the year 1986 a list of the transactions giving rise to the $30,008,920 increase in the loan. [Exhibit 426 at 119-124] From it can be derived:

Description	Amount	Comments
Advances	$ 3,337,213.74	
Repayments	(5,556,747.10)	
Intercompany transactions — cash advances	800,000.00	Transaction #16
	8,000,000.00	Transaction #16
	7,995,499.50	Transaction #17
	2,500,000.00	Transaction #10
Intercompany transactions — non-cash advances	12,932,954.00	Transaction #12
Net change for 1986	$30,008,920.14	

The repayments include a $3,100,000 repayment sourced from EL&F. On August 21 and 22, 1986, the monies came from EL&F's Merrill Lynch account and were placed in a PGL mutual fund account. [Exhibit 426 at 35, 124] According to Exhibit 426 at 133, the transaction was done in respect of the so-called capital injections of August, 1986. See: Transaction #18.

The repayments also include amounts funded by distributions from PSML and amounts paid on PGL second preferred shares. It can be seen that the majority of the increase in the loan balance during 1986 was attributable to the intercorporate transactions. Of the $2,420,833 repayments, $1,332,019 was sourced from PSML fees received by CSI and dividends paid by PGL to CSI. [Exhibit 426 at 119-121]

The balance of the loan as at December 31, 1986 according to Exhibit 428 was $67,383,561. The difference between this and the amount set out earlier, $66,598,596, is $784,965. That figure represents accrued interest for December, 1986. [Exhibit 426 at 118]

The net change in the PGL and CSL loan balance in 1985 was $4,804,250.0 It is broken down as follows (net figures): [Exhibit 426 at 131]

Advance regarding PMF	$3,367,455
Repayment from CRL	(520,331)
Repayment from Marlin	(150,284)
Advance to Marlin Management Inc.	1,001,876
Advance to CIL	1,060,981
	$4,759,697
Difference	$ 44,553

Exhibit 337 at 20 and 21 shows a net change for 1985 of the same amount, $4,804,250. Of that, $176,345 is attributable to a "downstairs" loan [Exhibit 426 at 21; Exhibit 428] which, when deducted, makes Stefanski's figure comparable to that of the Trustee. The evidence does not reveal the nature of this "downstairs" loan.

The net change between CSL and PGL over 1984 was $16,389,599. [Exhibit 426 at 130] CSL then advanced the following (net figures) to:

	CRL	$ 2,717,240
	CIL	2,475,705
	AHL	12,452,040
	Marlin	92,606
(1)	Qualico	(1,000,000)
		$16,737,591 (2)
	Difference	$ 347,992

(1) Payment received on Speedway Lands Agreement for Sale.

(2) Of these amounts, $12,500,000 was returned to PGL as payment for shares in Transaction #2.

As can be seen from the above, the net change in the advances for the year 1984 not attributable to Transaction #2 is $3,889,599. A review of the PGL/CSL loan ledger [Exhibit 337] shows a net change for 1984 of $3,884,160 (miscellaneous) and $12,500,000 (AHL share purchase, Transaction #2).

On the balance of probabilities, the advances prior to 1984 were cash. [Exhibit 426] In 1984, $12,500,000 of the cash was paid back to PGL. While lent interest-free, and while available again for investment, PGL assumed in the course of the transaction an obligation to pay dividends on $12,500,000 of new preferred shares. It did not receive any new funds in return.

Finally, Stefanski has set out in great detail the loans and repayments to PGL in 1987. [Exhibit 426 at 41-46; 75-82 and 118]

Loans were:

Date	Amount	Comment
March 31, 1987	$2,500,000.00	Transaction #10; East/West #3
April, 1987	1,000,000.00	From a PGL brokerage account Lent and paid same day
May, 1987	114,000.00	Lent on to CSL then to CIL Lent on to AHL, then to AEL
June, 1987	81,000.00	Lent on to AHL, then to AEL Lent to PSL re bonding
July, 1987	2,134,272.76	Sale of PGL mutual funds and applied to ELF account 60-48HE-4
	$5,829,272.76	

Repayments were:

Date	Amount	Comment
February, 1987	$1,800,000.00	Sale of CSI mutual funds
April, 1987	120,000.00	Received from CRI. Loaned to Petracca re house purchase
April, 1987	1,000,000.00	Loaned and paid same day
May, 1987	1,022,373.81	Sale of CSI mutual funds
July 22, 1987	1,540,475.82	Sale of CSI mutual funds
July 28, 1987	536,834.59	Hunter deal unwound
July 29, 1987	700,000.00	Money from PSML
July 30, 1987	1,000,000.00	Money from PSML
July 30, 1987	1,242,000.00	Sale of EL&F mutual funds
August 4, 1987	800,000.00	Money from PSML
	$9,761,684.22	

December 31, 1986 balance	$66,598,596.32
Advances	5,829,272.76
Repayments	(9,761,684.22)
	$62,666,184.86
Accrued interest (Dec/86 to Aug/87)	1,892,278.85
August 31, 1987	$64,558,463.71

[N.B. Exhibit 426 at 118 contains an addition error of $800,000, and overstates the loan balance by that amount.]

The repayments recorded include $2,500,000 from PSML. There is some question whether they ought to have been recorded as repayments of the loan. [15706-9; 15773] In any case, $2,500,000 of 1987 repayments came from PSML. [Exhibit 612 at 1; Exhibit 426 at 44-5]

The total loan repayments to PGL, August 1984 to August 1987, which were sourced from PGL dividends and fees received from PSML were:

Date	Amount	Exhibit Reference
November 30, 1984	$ 223,540	426 at 21
December 17, 1984	249,200	426 at 21
December 31, 1984	334,804	426 at 22
March 22, 1985	146,631	426 at 24
March 29, 1985	48,496	426 at 24
April 22, 1985	116,893	426 at 24
April 30, 1985	90,063	426 at 25
May 31, 1985	187,750	426 at 25
June 28, 1985	146,038	426 at 26(1)
September 30, 1985	112,000	426 at 27
October 31, 1985	45,000	426 at 28
November 29, 1985	130,000	426 at 28
December 31, 1985	94,000	426 at 30
December 24, 1985	175,000	426 at 30
January 31, 1986	70,000	426 at 22
February 28, 1986	116,000	426 at 31
March 31, 1986	148,330	426 at 32
April 30, 1986	261,511	426 at 33, 122
May 30, 1986	178,724	426 at 33, 122
December 31, 1986	175,000	426 at 123
	$3,048,980 (2)	
July, 1987	2,500,000	
	$5,548,980	

(1) It is assumed that $74,416 which was received on the same day from AHL was applied in payment on the loan, such that the balance of that payment after deducting $74,416 was sourced from PSML fees.

(2) $599,200 of which is dividend income from PGL second preferred shares.

The Trustee's figures for 1984 and 1985 correspond roughly to Stefanski's evidence. They are based on the change in the "Due from Parent Company" line on the audited PGL non-consolidated balance sheet. In 1984, the Trustee has deducted $12,500,000 from the change which is known to arise from Transaction #2. [Exhibit 275] The 1986 figure is the change in such balance [Exhibit 276] less reconciled transactions (known intercorporate transactions) and the 1987 figure is from a PGL trial balance. The figures for 1986 and 1987 vary considerably between Stefanski and the Trustee. The reason is that the Trustee has counted the funding of Hunter and East/West #2 transactions ($5,000,000 in 1986, Transaction #10) as part of the loan when in fact these payments according to Stefanski's records were funded from CSI mutual fund accounts, or the use of other CSI brokerage accounts. [Exhibit 426 at 39] Moreover, the amount stated on the 1986 draft PGL balance sheet includes accrued interest. I accept Stefanski's figures for the years 1986 and 1987. Stefanski's figures expressed in the same fashion as those of the Trustee would show:

Unreconciled advances:		
1984 advances (net) (1)	$ 3,889,599	
1985 advances (net) (2)	4,804,250	
1986 repayments (net) (3)	(2,219,533)	
1987 repayments (net) (3)	(3,932,412)	
Net advances	$ 2,541,904	
December 31, 1983 balance	15,395,827	
	$17,937,691	$17,937,486
Intercompany transactions:		
Transaction #2	12,500,000	
Transaction #12	12,932,954	
East/West #1	2,500,000	
Transaction #16	8,800,000	
Transaction #17	7,995,499	
East/West #3	2,500,000	
	$47,228,453	$47,228,453
		$65,165,939

(1) Net change calculated, *supra*, less $12,500,000.

(2) Exhibit 337 at 20-21; net change calculated, *supra*. As noted *supra*, $176,345 relates to an entry characterized as a "downstairs" loan.

(3) Figures are as stated, *supra*.

It must be remembered that total loan repayments were in part made possible by receipt of PGL dividends and amounts received from PSML by CSL/CSI in the form of fees. The combined amount is $5,548,980.

For the most part, as can be seen from the above figures of both Stefanski and the Trustee, loan transactions created the intercorporate debts. However, substantial amounts are not attributable to these transactions. The funds in the first instance came directly from PGL or later PSML and in some cases, from PGL promissory notes. Because of the funding of "surplus" and other payments made by FIC and AIC to PGL, FIC and AIC indirectly funded a portion of the loans. PGL indirectly funded a large amount of the repayments by virtue of the transfer of PSML to CSL on August 15, 1984.

I have noted elsewhere that the advances relating to Transaction #10 were ultimately paid to FIC. From CSI's perspective, the loans were secured by over valued Matrix shares and mutual funds and CSI was last in priority on the security. It was at high risk of not being repaid.

Based on all of the above, I have discovered evidence tending to show that the businesses of FIC and AIC and their affiliates CIL, CRL, CSI, CSL and PGL were at various times carried on in a manner that was oppressive and unfairly prejudicial to and unfairly disregarded the interests of security holders of those companies including the investment contract holders and the holders of the PGL promissory notes, by virtue of the lending practices of these companies. The lending practices included:

(i) Lending to affiliated companies and members of the Cormie family at significantly less than market rates of interest without security of any nature and without regard to the borrower's ability to repay.

(ii) Permitting the "rollback" of interest owing in respect of such loans without regard to the underlying cost of the funds.

(iii) Permitting the replacement of interest bearing loans with non-interest bearing loans so that by August 31, 1987, of the $64,558,463.71 owed by CSI to PGL $48,621,577.37 was interest free.

(iv) Lending funds for the purposes of Transaction #10 which were subsequently lent by CSI on poor security and without regard to the borrower's ability to pay, indeed the loans were without recourse except to the security.

(v) Lending funds at no interest for the purposes of Transaction #2, thereby incurring an obligation to pay dividends on the preferred shares without receiving in return any new money. While the preferred shares are, of course, not in priority to the noteholders, dividends (in one form or another) were in fact paid on those shares and PGL fully intended to pay the dividends when the shares were issued in order to ensure that AHL could pay dividends on its preferred shares to FIC and AIC.

While I have stated elsewhere that Transactions #12, #16 and #17 are evidence tending to show matters within my mandate, the flow of funds through the intercorporate accounts standing alone is not significant.

4. **County Investments Limited**

CIL was connected with the Principal Group by virtue of its borrowing from CSL/CSI or their affiliates. According to the evidence the only function CIL performed was to borrow money as stated and to lend money to members of the Cormie family and other affiliates of CSI/CSL.

No member of the Cormie family was ever a director or officer of CIL. The consistent practice throughout the history of CIL was that personnel otherwise employed by PGL were the sole shareholders and directors of CIL. Jude Halvorson was such a person, as was Stefanski. Halvorson testified that when she became Donald Cormie's private secretary [22714] she was told she would be doing work mainly for PGL, with her salary being paid ¾ by PGL and ¼ by Cormie Kennedy, as it was then known, an Edmonton law firm. [22714] She was told that it was the practice that Donald Cormie's secretaries purchased shares in CIL [22716] and it was indicated that CIL would lend her money to purchase the shares. [22717] She repaid the loan to purchase the shares which was in the principal amount of $3,500 at the rate of $100 per month [22718] and any dividends she received went to reduce the loan balance. She was also to be a director of the corporation. [22719] Her direction as to how to prepare the minutes of the directors came from Donald Cormie. [22723] Halvorson did not know what the business of CIL was, but to her it seemed "like it was a bank, a little bank". [22722] Any directors' resolutions she prepared were approved by Donald Cormie before she signed. [22735] When a family member wanted a loan, Halvorson would not authorize it, but it would be discussed with Donald Cormie. [15364]

Was CIL an affiliate of the investment contract companies? Affiliate is defined in the *BCA*, ss. 1(a.1) and 2(1) and (2) as fully set forth in Chapter I of this Report, The Mandate.

On the corporate chart entered as Exhibit 305, all of the bodies corporate shown are in some way related one to the other. CIL is incorrectly shown as being owned by CSL. But, was CIL an affiliate of FIC and AIC? This issue in my view reduces to the question of whether the shares of CIL were held for the benefit of Donald Cormie. If they were, CIL is affiliated with FIC and AIC within the meaning of s. 2 of the *BCA* by virtue of Donald Cormie's control of each of these corporations.

There is a significant amount of evidence in Donald Cormie's testimony which leads me to conclude that he was the beneficial owner of the CIL shares and that the shareholders of record were merely agents or nominees of Donald Cormie. In this regard I find that the evidence tends to show:

(a) All of the registered shareholders and directors of CIL were "hand-picked" by Donald Cormie and were, generally speaking, under his control in the sense that they were employees of Donald Cormie's companies.

(b) All major decisions regarding CIL were effectively made by Donald Cormie by way of "advice" to the registered shareholders or directors. The registered shareholders and directors made few, if any, independent decisions; Donald Cormie could not recall any time when his instructions were not followed. He admitted that the only person with information regarding CIL, besides the bookkeepers, was himself.

(c) Donald Cormie effectively controlled CIL's finances. Decisions as to when the family loans would be called by CIL were effectively made by Donald Cormie. It would appear that any loans which were demanded without direct authorization from Donald Cormie were demanded on the basis of his prior instructions. Also, the evidence indicates that Donald Cormie had bank signing authority for CIL although any 2 of certain other persons, including Donald Cormie's personal secretary, also had signing authority.

(d) The amount of dividends which were to be paid to the registered shareholders of CIL was approved by Donald Cormie.

(e) On occasion Donald Cormie held himself out to be a representative of CIL and enquiries regarding the company were directed to him and not the shareholders or directors of record.

(f) The minute book for CIL was kept in Donald Cormie's office together with the minute books for all of the other private companies.

I find that Donald Cormie and the directors and shareholders of CIL had no intention of creating in these directors and shareholders the full legal rights, powers and privileges enjoyed by officers and directors; rather, such rights were to be exercised at the instance and under the supervision of Donald Cormie. The evidence tends to show that CIL was a sham created to avoid tax. If any member of the Cormie family had owned shares in CIL and loans were made to the shareholders for more than one year, the money would be deemed income in the hands of the Cormie family member according to s. 15(2) of the *Income Tax Act*. By having secretaries or employees "own" the shares in and be the directors of CIL, Donald Cormie and the Cormie family attempted to avoid tax by borrowing money from a company which, on its face, was not "connected" within the meaning of s. 15(2) of the *Income Tax Act* with Donald Cormie and members of his family.

In accordance with my mandate I am to determine whether or not the evidence tends to show that the business of FIC or AIC or any of their affiliates has been carried on with intent to defraud any person, whether the business or affairs of FIC or AIC or any of their affiliates is or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of a security holder; whether or not FIC or AIC or any of their affiliates was formed for a fraudulent or unlawful purpose; and, whether persons concerned with the formation of business or affairs of FIC or AIC or any of their affiliates have in connection therewith acted fraudulently or dishonestly.

The evidence I have discovered tends to show that CIL was an affiliate of FIC and AIC which was formed for the purpose of deceiving the tax authorities; it was formed and operated so that it would appear to be something which it was not, i.e., not a corporation connected with Donald Cormie and members of his family. The evidence tends to show that this was done for a fraudulent and dishonest purpose.

5. Estate Loan & Finance Limited

EL&F is a company which received substantial payments from PGL or from FIC in respect of the sale of investment contracts. The history and amounts of those payments are discussed in this part of the Report.

Donald Cormie did not legally own nor was he an officer or a director of EL&F. Eivor Cormie, Donald Cormie's wife owned the common shares of EL&F. EL&F owned premises in Victoria, British Columbia and Scottsdale, Arizona at which conferences were held from time to time.

The evidence with respect to the direction and control of EL&F was provided by Donald Cormie, Nicholson, Halvorson, Stefanski and James Cormie. I am satisfied that for all practical purposes Donald Cormie directed the business and affairs of EL&F. I do not find that EL&F was an affiliate of FIC and AIC as I do not view the evidence before me as establishing that fact one way or the other.

Soon after Stefanski joined PGL [7720] she became the personal accountant for AHL, CSL, CSI, CRL, the investment portion, CIL, JAIL, Wyocan Cormie Farms, Heritage Farms and EL&F. [7720-7721] She commenced her employment in September, 1981 and was continuously employed until the summer of 1987. [7722] She was also the accountant for Department 8. [7722]

Stefanski was a shareholder of EL&F from September 15, 1981 until August, 1987. [15734] She ostensibly held the shares in trust for Eivor Cormie. [15735] She and Halvorson were the directors of EL&F. [15735] Donald Cormie would instruct her relative to the corporate affairs of EL&F. [15737]

Donald Cormie exercised complete control over EL&F. Further evidence of this is set forth in the testimony of Halvorson and Stefanski. Halvorson held shares of EL&F in trust for Eivor Cormie. [Exhibit 515 at 80] Halvorson executed a power of attorney in favour of Eivor Cormie. [Exhibit 515 at 81, 82] Halvorson was never told why she was to hold the shares in trust or why she executed the power of attorney. [22753]

The minutes of EL&F were prepared on Donald Cormie's instructions. They were reviewed by him and thereafter Halvorson would sign them. [22754]

Payments were made to EL&F primarily from PGL as set out in Exhibit 485. The categories of payment in the main are comprised of the sales distribution management fee, conference fees and additional conference rent.

The total sales distribution management fee for the 5 year period 1982 through 1986 inclusive, as shown in Exhibit 485, amounts to $1,580,975. For the same period, conference fees amount to $375,000.

Many witnesses were asked what the sales distribution management fee was for. The external auditor, McCutchen, said he was aware of no written agreement between EL&F and PGL with respect to the payment of this management fee, but that Donald Cormie told him it was a management fee for the purposes of EL&F and the assistance of Principal Group products. [24771] McCutchen, as the external auditor engagement partner on behalf of Deloitte Haskins & Sells, did not satisfy himself from any source as to whether or not management services were being provided other than relying on Donald Cormie's word. [24772] He relied on Donald Cormie's word and accepted it, combined with the fact that the expenditure was being made. [24772] It was represented to the Alberta government in June, 1987, by virtue of Exhibit I to Exhibit 300, also found in Exhibit 436 at 32, that management advisory fees were paid to EL&F in 1986 in the sum of $360,000 as an expense to PGL. It was also indicated that for conferences and conventions held at premises owned by EL&F, PGL and subsidiaries were charged per person and per event and that this was estimated at the beginning of the year and prepaid monthly. At the end of the year, final payment was requested or refunded to cover any deficiency or overage.

Donald Cormie was asked repeatedly in examination why PGL paid sales management fees to EL&F. The reasons described by Donald Cormie are historical, in that he agreed that EL&F would do the hiring and development of the sales force for FIC in 1956. [16530-31]

A letter dated May 26, 1976 from Deloitte Haskins & Sells appears in Exhibit 436 at 24 in response to a request from Clarkson Gordon who had been hired by the Superintendent of Insurance of the day, Jim Darwish. It is indicated at 27 and 28 that the basis of the fee charged by EL&F was "originally" related to the development of a hiring and marketing program and was dependent on the results, namely gross sales volume. It developed that an override of $4.50 per $1000 of sales was paid.

A number of FIC directors' minutes are in evidence. [Exhibit 436 at 69-77] In the late 1950s, Donald Cormie was a director and the chairman of FIC. The minutes of a directors' meeting December 19, 1958 [Exhibit 436 at 74] indicate management fees of $6,410 per month will be paid to EL&F to manage the entire sales organization. The management services of Donald Cormie were terminated by the same resolution. In 1958 neither PGL nor PCL existed; FIC had its own office, staff and sales force. [16535]

The next documentary evidence, chronologically, is in Exhibit 435 at 20 which is a letter dated December 12, 1973 from PGL to FIC referencing the distribution agreements. In this letter, Ray Callies of PGL indicates that there are a number of current agreements in effect that were made in 1970 and 1971 with respect to marketing and distribution. It states in paragraph 3:

> In addition we acquired the right to all the marketing programs and goodwill as developed by Estate Loan & Finance Ltd. and agreed to assume your obligation to pay that company the cumulative amount equal to $5.00 per thousand of all sales made, agreed to by you at the time the original sales and marketing programs were developed in the 1950's and early 1960's as referred to in your minutes. That company advises that since such payment obligations for the marketing were based on results that would only occur in future years, that they are to be secured by an assignment of, and a first charge on, all trail commissions, that were not vested in particular salesmen. Since the sales vary, that company has been drawing amounts not exceeding $9,700.00 in any month.

Marlin, on behalf of FIC, acknowledges and concurs that the arrangement should be formally documented. [Exhibit 435 at 22]

It never was.

Donald Cormie was asked why FIC would be obliged to pay any money to EL&F after 1973 when the clause in the above letter states PGL is going to assume FIC's obligation to pay EL&F. [16541] Donald Cormie was also asked why, when EL&F quit managing the sales, would EL&F be paid anything. He replied that EL&F "never did quit managing the sales, they went on in the forward planning strategic planning". [16544] But Donald Cormie did admit that EL&F quit managing the entire sales organization. [16544]

Donald Cormie's explanation as to the forward planning or strategic planning services provided by EL&F was in respect of the mutual funds [16548], and that this involved the cyclical theory work inside EL&F. [16548]

Although Donald Cormie indicated that he and his wife would go to dances or parties for the sales group in every sales area twice a year, [16548] he ultimately indicated that James Cormie, John Cormie and Donald Cormie were the only persons that performed services in EL&F for which EL&F could legitimately charge PGL. He also said that the work product supplied by EL&F to PGL was not written down, but was all verbal or oral after 1975. [16555-67 ff.]

Much was made of the suggestion that Allison Cormie, who was paid a salary by PGL in the sum of $120,000 for the 13 month period ended August 31, 1987, [Exhibit 337 at 66] did work with respect to carbon dating and the development of the cycle theories to predict economic developments in the future. This part of the forward planning function was stated to have been performed by Allison Cormie for PGL [16566] and not for EL&F [16566] so that EL&F could not be earning a fee for forward planning of the economic cycles in respect of Allison Cormie's work. [16566]

In short, EL&F did nothing after 1973 to earn the so-called sales distribution and management fee. Any forward planning that was done by Allison Cormie was oral or verbal and was paid for by PGL. Any strategic or forward planning done by James Cormie, John Cormie or Donald Cormie was a function they were paid for in their capacity as officers and directors of PSML or PGL. The sales distribution management fee of $1,580,975 for the 5 year period 1982 to 1986 in Exhibit 485 was paid for no justifiable or even plausible reason.

Donald Cormie's evidence was that PGL paid EL&F for management advisory services from the $18.87 derived from the sale of investment contracts in the example given at page 263 of Exhibit 258 and discussed above. There was no written agreement in respect of the payment to EL&F. [16530]

I find in the context of my mandate that the evidence tends to show that the affairs of FIC and AIC and PGL were conducted, and the powers of the directors of PGL, namely James Cormie, John Cormie, Donald Cormie and Marlin were exercised, in a manner that was oppressive and unfairly prejudicial to the interests of the investment contract holders of FIC and AIC and the promissory note holders of PGL by reason of the above described payments by PGL to EL&F after 1973.

To the extent that Donald Cormie states that the money was paid to EL&F pursuant to a distribution fee arrangement based on the sales of FIC and AIC, there was no justification for paying any such fees, at least after 1973. To the extent that there is an attempt to justify the fee on the basis of strategic or forward planning, the evidence tends to show that there is no merit to this suggestion.

The conference fees received by EL&F were increased from $5000 to $8000 per month, effective September 1, 1984, which was a "minimum amount" paid by EL&F on a monthly basis for use of the conference centres. [22755] This direction was given by Donald Cormie on behalf of EL&F by a letter signed by him dated July 5, 1984, addressed to Nicholson of PGL. [Exhibit 515 at 85]

The evidence of Nicholson was the flat amount, $8000 per month was prepaid and then the actual usage was invoiced from EL&F to PGL. [23627]

Page 93 of Exhibit 524 shows the actual usage was $120,793.75 in 1985 and $105,590 in 1986.

The evidence was that the conference centre in Victoria as well as the Scottsdale residence belonged to EL&F, notwithstanding registration of title to the Victoria property in the names of Donald Cormie and Eivor Cormie. These charges were not shown in the evidence to be unreasonable and I make no finding as to whether or not the evidence tends to show the reasonableness of the fees for the conference centre facilities one way or the other.

6. Capital and Other Injections and Operations of PGL

Another kind of money out was the practice of injecting "capital" into FIC and AIC. PGL injected both cash and secured promissory notes into the investment contract companies. Usually, a cash injection was supported by a promissory note issued by the investment contract company and subordinated to the claims of other creditors. Where cash was not injected, "back to back" notes were issued. PGL thereby promised to pay a certain sum and secured its obligation with collateral. The investment contract company would issue a subordinated note in return. The amounts outstanding as of December 31, 1986 are as follows: [Exhibit 611, Appendix 5; Exhibits 272 and 273]

	FIC
Amount	**Comment**
$ 6,300,000	Dec. 27, 1984 Cash. Note 3.
5,000,000	Dec. 17, 1984 Cash. Note 3.
$11,300,000	Cured the harm done in Transaction #1
$ 500,000	Dec. 1983 Cash. Note 6.
$ 1,200,000	Feb. 1982 Back-to-back note. No cash.
$ 2,000,000	June 1982 Cash.
$ 1,000,000	1974 Back-to-back note. No cash. Note 4.
$ 2,000,000	1974 Back-to-back note. No cash. Note 5.
$ 9,568,000	Aug. 1986 Back-to-back note. No cash. Note 1.
$27,568,000	

	AIC
Amount	**Comment**
$ 800,000	Originally issued 1981. Cash equivalent (credit to intercompany account).
$ 400,000	Originally issued March 1982. Cash.
$ 500,000	Dec. 1983. Originally issued in 1982: Exhibit 273 at 58. Cash.
$ 500,000	Dec. 1983. Cash.
$2,000,000	March 1985. Cash in the first instance Note 7.
$1,683,000	Aug. 1986. Back-to-back note. No cash. Note 2.
$5,883,000	

Notes:

(1) Secured by mutual fund units. Called by Coopers & Lybrand Limited and paid out after June 30, 1987.

(2) Secured by mutual fund units. Paid out May, 1987 by management.

(3) Cheques drawn on PGL "Notes" account: Exhibit 611, Appendix 5.

(4) Secured by Speedway Lands Agreement for Sale. Note however that in June, 1986 the Agreement for Sale was sold to the investment contract companies: Transaction #15.

(5) Secured by Speedway Lands Agreement for Sale and PLIC shares. As to the Agreement for Sale, see Note 4, *supra*.

(6) Not recorded on the financial statements until 1984.

(7) Inserted in cash by cheque dated March 29, 1985. However, on April 1, 1985 the cash was returned to PGL in return for $1,831,607 in AHL preferred shares and a credit to intercompany account of $168,393: Exhibit 611, Appendix 5.

The following table shows the evolution of the capital injections:

Subordinated Notes Balances

	AIC	FIC
1974-79	(1)	3,000,000
1980	(1)	3,000,000 (2)
1981	800,000	5,200,000 (3)
1982	1,700,000 (7)	8,200,000 (4)
1983	2,200,000	6,200,000 (5)
1984	2,200,000	18,000,000
1985	4,200,000 (6)	18,000,000
1986	5,883,000	27,567,649
Advances by PGL post-1981	5,083,000	22,367,649

[Exhibits 272, 273, 548, and 549; 633 at 106]

Notes:

(1) AIC held a debenture from PGL repayable in monthly instalments and due June 1, 1988. It was issued in 1971 for approximately $2,800,000 [Exhibit 342 at 15] and also secured on the Speedway Lands. AIC held various other notes and debentures over the years but by 1980, it held only this debenture. The debenture was steadily repaid. By December 31, 1986 the balance stood at $204,687. The debenture arose from a convoluted series of transactions detailed in Exhibit 553, and for which AIC paid, *inter alia*, $2,400,000 cash. It was not a "capital injection". This is in contrast to FIC, which historically held debentures from the parent as capital injections.

(2) Consists of back-to-back notes secured by the Speedway Lands Agreement for Sale and the PLIC shares.

(3) New $1,200,000 injection, secured by PLIC shares and Speedway Lands Agreement for Sale (appraised value $4,700,000 against obligations of $4,300,000). A second $1,000,000 injection was cash. Both injections were made to cover a decline in stock prices. [Exhibit 550 at 38]

(4) Additional $3,000,000 injection in cash. [Exhibit 550 at 141] The purpose was to cover operational losses. [Exhibit 550 at 38]

(5) $2,000,000 in cash was repaid to PGL on the maturity of notes issued in 1982 and 1983.

(6) "Cash" injection of $2,000,000 converted almost immediately to AHL preferred shares.

(7) All of these notes were originally issued for cash. [Exhibit 551 at 115] One $500,000 note matured in June, 1983 and was paid. Another $500,000 note was re-issued to replace it prior to that year end. [Exhibit 273 at 47; Exhibit 550 at 115.]

The trustee in bankruptcy has submitted evidence that PGL made the following advances to FIC and AIC from and including 1984: [Exhibit 611, Appendices 3 and 4]

Description	Amount	Comment
Direct Advance, 1984	$11,300,000	Transaction #1
	273,416	Exhibit 611
Direct Advance, 1985	2,000,000	Exhibit 611 (converted to AHL shares)
Indirect Advance, 1986	11,250,649	Transaction #18
Indirect Advance, 1986	7,500,000	Transaction #10
1984 payment on AIC debenture	129,668	Exhibit 611, Exhibit 273
1984 payment on accrued interest on FIC debenture	226,584	Exhibit 611, Exhibit 272
1985 payment on AIC debenture	139,336	Exhibit 611, Exhibit 273
1986 payment on AIC debenture	149,261	Exhibit 611, Exhibit 273
Other payment of notes and interest	213,110	Exhibit 611 (cannot further identify the nature of the payments)
TOTAL	$33,182,024	

The payments on the AIC debenture were pursuant to that obligation incurred in 1971. They cannot be considered a capital injection. The same is true of Transactions #1 and #10. Transaction #1, discussed elsewhere and for the reasons expressed in that discussion, can not be considered a capital injection. Nor can Transaction #10. They are, however, injections of funds.

Thus, total capital injections from 1984 to June, 1987, including the later payment on the Transaction #18 subordinated promissory notes, was $13,963,759.

The PGL trustee in bankruptcy has argued that PGL promissory note money, previous cash balances, and the cash component of certain reversed levies were the material cash inflows of PGL. That cash was used to lend to CSL, to fund operating losses, to purchase certain shares and other assets, and to pay down to FIC and AIC. It is not necessary to set out in detail the schedules prepared by the Trustee in setting out material cash flows. It is only necessary to note that the major expenditures of PGL for the years 1984 through 1987 were indeed payments to FIC and AIC and the funding of operating losses of approximately $12,890,000.

Included within operating losses are the fees and charges paid by FIC and AIC, some $42,460,000 over the period. The Trustee has defined operating losses as the cash flow deficiency from operations (net loss plus non-cash items on the audited PGL Non-consolidated Statement of Changes in Cash Position). The subsequent reversal of levies and interest which were paid in cash in the first instance, are not a component of loss in that statement since, once reversed, these amounts were not recorded as revenue.

The net inflow of promissory note money from January 1, 1984 to August 10, 1987 was $32,970,599. [Exhibit 611, Appendix 4]

From January 1, 1984 to August 10, 1987, PGL suffered an erosion of some $40,400,000 million to its asset base, as set out below. [Exhibit 611, Appendix 3]

Further advances to FIC and AIC	$33,182,024	
Loss of intercompany accounts available for set-off (1)	5,049,536	
	$38,231,560	$38,231,560
New investment in PS&T	$ 2,000,000	
Reduction in realization of PS&T notes	4,313,809	
	6,313,809	6,313,809
Losses from operations:		
1984	$ 432,934	
1985	6,583,737	
1986	5,273,046	
1987	1,318,907	
	$13,608,624	13,608,624
Reduction in estimated realization of PSML	$ 3,700,000	
Dividends paid	3,484,816	
	$ 7,184,816	7,184,816
TOTAL		$65,338,809
Less:		
Preferred shares issued to AHL (net)		(9,800,000)
Net intercompany gains (excluding parent)(2)		(15,407,439)
		$40,131,370

(1) That the right of set-off was lost was an assumption made and expressed in Schenkelberg's evidence. I express no opinion on the issue.

(2) The gains are shown in Exhibit 611, Appendix 9, Schedule 1 and are primarily attributable to Transactions #3 (sale of the debentures), #7 and #9 (transfers of shares to FIC and AIC).

Funds flowed from FIC and AIC to PGL in the form of fees, levies, surplus, commissions and subordinated note interest. Eliminating waived amounts not repaid in cash, the following can be developed: [Exhibit 611 at 49-50]

	Surplus	Levy	Note Interest	Selling Commissions	Total
Dec. 31/84	$ 4,070,489	$ 4,261,087	$1,061,723	$1,272,607	$10,665,906
Dec. 31/85	4,501,670	4,466,541	2,744,516	1,575,309	13,288,036
Dec. 31/86	7,951,002	3,196,037 (1)	3,242,313	2,296,910	12,686,262
June 1987	2,338,456	2,640,582	1,903,879	1,375,234	8,258,151
	$14,861,617	$14,564,247	$8,952,431	$6,520,060	$44,898,355
					2,441,729 (2)
					$42,456,626

(1) Net of $1,200,000 repayment. For the purposes of the schedule the entire repayment has been allocated to the levy rather than split between the levy and subordinated note interest.

(2) PGL paid subordinated note interest of:

1984	$350,000
1985	$400,000
1986	$889,000
1987	$810,000

This excludes payments on the AIC debenture which resulted from a commercial transaction.

As noted earlier, PGL paid or secured subordinated notes to FIC and AIC over the period 1984 to 1987 in the amount of approximately $24,824,065 and paid accrued interest on the FIC debenture of $226,584. The total payments were $33,182,024.

A summary of the charges FIC and AIC paid to PGL as against the actual expenses is provided elsewhere (see Chapter VI). Even after deducting the Trustee's maximum allocation of expenses for 1984 and following (approximately $12,970,000), PGL received more than what it cost to run the two subsidiaries.

Some idea of the significance of the operations of FIC and AIC to PGL can be gained by considering the revenue of PGL unconsolidated basis after removing gains on sale of securities, a non-cash item. As noted earlier, the Trustee calculated the deficiency from operations for the period 1984 through August 10, 1987 to be $12,888,434. [Exhibit 611 at 92] The deficiency is based on reported figures from financial statements, which did not record waived amounts as income. As noted the waived amounts for the year 1984 and 1985 alone exceeded $10,000,000.

It is obvious from Exhibit 611 at 14 that cash flow from operations was insufficient to fund the payments down to FIC and AIC. Some of it had to be note money and as mentioned already, the 1984 "capital injections" came from the note account.

What this evidence tends to show is that PGL was heavily dependent on FIC and AIC to fund its operations. Its operations in this context included meeting regulatory demands or responding to regulatory pressure to insert assets in FIC and AIC. It is more evidence explaining why the "surplus" was charged and why PGL was reluctant to repay "forgiven" amounts in cash. After January 1st, 1984 PGL could not afford to; it was unable to.

C. INVESTMENT STRATEGY AND PRACTICES

1. Introduction

The general statements found in Annual Reports of PGL as to investment strategy are to the effect that the most important factor in the Group's success is its strategic planning capability, coupled with its belief in corporate planning based on solid economic research, and the analysis of both economic trends and financial markets. The President's Perspective contained in the 1978 Annual Report [Exhibit 186] for example, stated:

> Principal Group believes in corporate planning based on solid economic and market research. We consider Principal the leading company in western Canada in analyzing economic trends. Our research indicates a substantial increase in the North American equity markets over the next four years. Not since 1921 have North American equity prices been so inexpensive relative to real estate prices. . . . Today there are a large number of bargains in the stock market. Our skill and expertise in selecting the right stocks that will reflect the best returns is now vital.

That report stated that the securities portfolio, consisting largely of government and corporate bonds and cash equivalents, totalled 51% of total assets, consistent with the "plan to diversify away from a dependence on mortgages".

The President's Perspective in the 1979 Annual Report was similar, again anticipating a stock market boom of major proportions and a plan to diversify away from a dependence on mortgages. [Exhibit 186] The same was said in the 1980 Annual Report. [Exhibit 186] Donald Cormie wrote in the 1981 Annual Report:

> Because of our diversification into a very liquid investment portfolio, Principal was not hurt as much as others by the proposed federal budget. The resultant pressures in real estate and mortgage portfolios affected us less since we had, as planned, moved away from a dependence on mortgages. We had diversified into a portfolio of cash and securities consisting largely of bonds and, and to a smaller degree, stocks. . . . [Exhibit 186]

It is also stated in the 1981 Annual Report that Principal's ability to withstand an adverse economic environment is the result of its long-term strategy of having a balanced approach to ensure preservation of capital: a strategy of "protection first, gains second". [Exhibit 186]

The strategy for FIC and AIC as expressed in the 1982 Annual Report was:

> During the last five years management has analyzed trends in the economy and has realigned the companies' investments to take advantage of exceptional investment opportunities in the North American stock markets. Both First and Associated have adopted more dynamic common stock and bond portfolios based upon their parent company's sophisticated economic projections of major market moves in the 1980s.
>
> As a result of this strategy both firms have a high degree of liquidity in non-mortgage investments in addition to well positioned, high yielding mortgage portfolios. [Exhibit 186]

The overall strategy was described in the 1985 Annual Review as follows:

> 1985 was another outstanding year for Principal Group. In 1984, despite the overall weaknesses in the financial sector in Canada, we announced record profits of $4.4 million. In 1985 additional reserves in some of our subsidiaries reduced our profits to $607,000. For the first time, group assets under management exceeded $1 billion at year end, currently exceed $1.2 billion, and we anticipate will reach $4 billion by 1990 as our expansion continues.
>
> This accomplishment is not merely luck. Principal Group manages our clients' investments and our corporate portfolios using indepth analysis of long-term cycles and trends within our economy. By understanding these trends, we have been able to act rather than react. Our success in moving out of real estate in advance of its subsequent collapse and moving into the stock and bond market at its low points are examples of how this strategic planning works for us and our clients. We continually monitor current cycles and trends within our economy and adapt our strategies accordingly.
>
> As we indicated in 1984, one of our investment strategies was to diversify into non-regulated, public companies. The expansion of Principal Neo-Tech Inc., listed on the Toronto Stock Exchange, and Matrix Investments Limited, listed on the Alberta Stock Exchange, was part of this move.

> Principal Neo-Tech had a banner year in 1985. It emerged as one of the largest typeset and colour separation companies in North America, using the most up-to-date and innovative computer technology available. It is more than double the size of its nearest Canadian competitor. Principal Neo-Tech is also one of the most technologically advanced proprietary seismic data firms in the U.S. The success of PNI is reflected in its stock price, which more than doubled during 1985.
>
> Matrix Investments Limited began its diversification strategy in 1985 by acquiring Drummond Brewery Company Ltd., the largest independent brewery in Alberta. The company now has 40% of the total draught beer market in the Province of Alberta. The initial result of this diversification program is a rapid increase in earnings and an increase in share price of over 240% during 1985. [Exhibit 11 at 5]

The only policy manual that appears to have existed in the Group was distributed on June 10, 1974. [Exhibit 442, at 2a-15] It was issued by PGL and contained sections on investments and mortgages, among other matters. At that time the policy of the company was to progressively minimize its exposure in stocks and bonds and concentrate its investment in first class mortgages, and to exchange long-term investments for those over a shorter term (provided yields and liquidity were adequate). There was a direction that the Investment Committee prepare an investment plan at least quarterly. Mortgages were to be only first mortgages (second mortgages were approved only by the board of the company granting the mortgage and insured as to principal and interest repayment). The underlying security was to be adequate, and the yields in accordance with objectives as stated from time to time. The return on the mortgage portfolio was to provide a 4% spread over the cost of the money, and mortgages granted by the company were not to exceed 75% of the appraised value of the property.

FIC described its investment strategy as follows in a Preliminary Prospectus submitted to the ASC dated March 29, 1985: [Exhibit 372 at E127]

> The Corporation adopted a policy, following the conclusion of its 1982 fiscal year, which emphasizes investments in government and corporate bonds and stocks and de-emphasized mortgage lending. The Board of Directors is of the opinion that an increased investment in bonds and stocks will provide greater stability and liquidity with better prospects for growth in the medium and long-term. . . . The Board of Directors of the Corporation anticipate better prospects for returns in the stock markets during the medium term, and it is anticipated that investments in common and preferred shares will increase in relation to investments in bonds over the next two to three fiscal years.

That document also stated:

> In addition, the Corporation's policy is to limit its investment in any one issue of stocks and bonds to a maximum of 5% of its assets and to limit its investment in the common or preferred shares of any one corporation to a maximum of 1% of its assets.

The document also noted [at E133]:

> During its 1982 fiscal year, the Corporation initiated a program involving the making of loans secured against its Single Payment Investment Certificates, as well as the securities of the Affiliated Mutual Funds. All such loans are made on a demand basis and carry a floating interest rate at 2.5% over a major bank's prime rate. No initial loan secured by an Instalment Savings Certificate may exceed 90% of its cash surrender value and no initial loan security against other investment certificates or the securities of the Affiliated Mutual Funds may exceed 70% or 50% of value respectively. . . . The Corporation has not sustained any losses on loans advanced under this program since its inception.

Page E134:

> The main focus of the Corporation's new fund investment program during the past three years has been into the bond and stock markets.

> The company is focusing its efforts on improving its matching of funds by increasing the amount of collateralized loans and decreasing its mortgage and real estate portfolio. This program, under current economic circumstances and normal operating conditions, is expected to require another three years to complete.

The investment strategy was determined in meetings of the Investment Committee. Notes were not taken nor were minutes kept. While investment strategies would change to meet changing conditions, some general strategies appear in the evidence and are outlined hereafter. These are not necessarily consistent with the statements in the Annual Reports, the FIC Preliminary Prospectus or the policy manual.

2. Mortgage Lending

The mortgage department of PGL, in accordance with the functional management concept, was responsible for approving and administering mortgage loans made by FIC, AIC and PS&T. It was in possession of Mortgage Guidelines from the Federal Department of Insurance dated 1978 [Exhibit 516 at 116-7] which provided in summary as follows:

(a) Maximum single loan. The maximum size of single loans are 15% of borrowing base, where uninsured, and 25% where insured, and 35% where insured or guaranteed under the NHA or an agency of the government of any province.

(b) Composition of mortgage portfolio. Not more than 5% of the total mortgage portfolio should be lent uninsured to anyone of hotels and motels, recreation property, land, and real estate other than residential property not readily adaptable for more than one purpose.

(c) Interim financing. Considered not appropriate for insurance companies, presenting special risks and requiring a high degree of knowledge and skill, not more than 5% of the mortgage portfolio. As well, not more than 2% of the company's total mortgage portfolio should be lent on an uninsured basis to one developer or contractor.

(d) Large loans. Uninsured large loans should not exceed 20% of the total mortgage portfolio. A large loan is considered as a loan exceeding 5% of the company's borrowing base.

According to the Guidelines, where a company exceeds the above limits, significant additional risks are incurred and the Federal Department of Insurance would consider, in deciding whether and what action should be taken, the age of the company, experience and stability of management, profit history, and the matching of cash flow, both in and out.

Fuhr testified that the November, 1978 Guidelines were in place in the mortgage department through 1982, and were regarded as guidelines that it would be desirable to follow, although they were not binding. [22866-7]

Fuhr as mortgage manager from 1976 to 1983 attended a portion of the weekly Investment Committee meetings. [22857] Donald Cormie and James Cormie also attended. [22904] Certain risk standards for mortgage lending evolved through these meetings. It is clear from the evidence that risk standards, maximum loan sizes, loan interest rates and the amount of money to be placed were established and supervised by Donald Cormie and James Cormie.

The mortgage lending philosophy was described by Green. He had been involved in buying and selling mortgages for FIC since 1961. He became responsible for mortgage underwriting in about 1966 and became the manager of the Principal Group mortgage department sometime in 1968 or 1969, a position he held until 1976. [5580-84]

Green testified that PGL was never a conventional mortgage lender. A conventional mortgage lender, described as a prime rate lender, included banks, large insurance companies and most trust companies. [5587-8] He continued:

> The difference was that the rates that we charged for our loans were always greater than the prime rate charged by prime rate lenders. [5588]

Green testified that a mortgage applicant who could get cheaper money would do so rather than go to Principal Group and that it was generally true that the people to whom Principal Group lent money could not get financing from a conventional lender. [5588-9] As well, the higher interest rate was a reflection of the higher risk. [5588-9]

Green, who had left the employ of PGL in 1976, began to do some consulting work for PGL either in late 1981 or 1982 and rejoined PGL in 1983. [5595] He testified that by late 1982 the nature of the lending had changed considerably:

> In 1976 and years prior, we had built a fairly well-balanced portfolio, balanced geographically and by type of investment. By late 1982, as I became more familiar with the mortgage portfolio, it was obvious to me that the bulk of the investments were in Alberta *vis-a-vis* a greater geographical distribution, and there was a considerable amount of money invested in land-type mortgages, i.e., non-income producing real estate. [5589]

Green said that the well-balanced portfolio that had been built was based primarily on residential mortgages (50% or 60% of the portfolio), mixed in with some commercial and industrial loans and a "little bit" of land, hotels, "whatever". [5590-1]

Green testified that the lending policy in place prior to his departure in 1976 emphasized adherencce to the maximum loan limit set out by the regulatory bodies, which was 75% of appraised value (if uninsured). The policy of PGL at that time was to make loans only on appraisal, which primarily were outside appraisals. [5633-5]

From 1976 to 1983 Fuhr was the mortgage manager. His evidence was that the interest rates on mortgages were set by either Donald Cormie or James Cormie, and communicated to him most frequently by telephone or in an Investment Committee meeting. Fuhr was often instructed that surplus funds were available and had to be put into mortgages. The amount of money to be placed was set by Donald Cormie or James Cormie. Fuhr also testified that there was instruction or guidance from Donald Cormie and James Cormie as to the size of the individual loans. When he first took over as manager, the maximum loan was around $100,000. Around 1976 he was advised that the department could make larger loans. Most often, in the late 1970s and early 1980s, this large loan limit was provided by telephone. [22857-8; 22865-70; 22869] Thus written records of these matters are not generally available.

The borrowing base referred to in the Mortgage Guidelines was based on the unimpaired capital and surplus and was applied as such in the case of PS&T by the Federal Department of Insurance, CDIC and the Provincial Director of Trust Companies. The borrowing base then was used for the purpose of the application of the Mortgage Guidelines to PS&T.

In the case of FIC and AIC, spearheaded by Marlin, the position was taken that "$500,000 is the unimpaired capital required in an investment contract (company) and that is not an appropriate measurement for a borrowing base. If it were a trust company, it would be a capital ratio where you would have a 20 to 1 or a 15 to 1, and as your company grew in size, then your capital base would grow proportionately. That does not happen in an investment contract company." [11943]

Marlin went on to state that trying to equate unimpaired capital as the borrowing base in an investment contract company was simply the "wrong criteria" and that the proper criteria for such a company in his view was the asset base; i.e., whether or not there was $500,000 in capital after considering the reserve requirements. [11945-47]

As I indicated earlier in the Report, because of the shift in the products of FIC and AIC to single pay certificates, the business of FIC and AIC by 1980 became in essence akin to that of a trust company. The borrowing base for a trust company and the guidelines applicable to a trust company would in my opinion be entirely appropriate for an investment contract company. The position of PGL in terms of its investment strategy for FIC and AIC remained that it was not bound by the mortgage guidelines because a borrowing base as calculated for a trust company was inappropriate; therefore, the mortgage lending did not proceed according to the Mortgage Guidelines in the case of FIC and AIC.

Fuhr testified that from 1979 through 1982 there was much "equity and investment-type mortgage lending". Some of the lending was to people who were not dealing with or could not get money from the chartered banks, and which could involve making higher-risk loans. [22855-7] During that time, and very strongly emphasized after 1980, the lending ratios were dropped except on very rare occasions to below 60% of appraised value of the mortgage security. The interest rate charged by FIC and AIC exceeded that charged by the chartered banks by 2% to 6%. [22856-7]

Fuhr said that during the period 1976 through 1982, there was a problem in continuing the lending philosophy that Principal Group traditionally maintained because the volume of money to be lent out was increasing; one could never profit from this type of lending on a volume basis. Principal Group was picking and choosing from applicants that were perhaps left over from the prime lenders, and it took some time to consider in depth whether or not a loan should be made. In 1977 there was a quite high increase in placements required, based on instructions from Donald Cormie or James Cormie in the Investment Committee meetings. [22863-5]

Fuhr testified that when interest rates and inflation commenced to escalate in 1980, there was pressure on the mortgage department to place more and more mortgage money at what seemed to be higher and higher rates. The nature of the instructions to Fuhr were, in general, as to the amount of money to be placed and the rate and average term on that money. [22870-2]

In 1980 or 1981 Fuhr became aware during an Investment Committee meeting that a large pool of money had come in through certificate sales just before the interest rates had dropped. There was a directive from Donald Cormie and James Cormie that this must be placed as soon as possible. [22876-8] Fuhr continued:

> Well, essentially we began — at that particular time as well, the mortgage market that we had been used to tapping, which was the investment real estate market, I guess you could say, began to dry up. In other words, there was less availability of product, less people buying property and investing in property and it just seemed there was less of it around. But at the same time, we were looking for more homes for the money than we ever had. [22878]

While the standards of investment did not technically change, the department began reconsidering potential investments that it may have previously rejected "hands down" and the mortgage lending criteria or standards were relaxed. [22878-9]

Fuhr described the evolution of a number of loans which eventually became large problems for the companies. In his view, the real estate market was fast reaching its peak and had a volatility that was quite risky. His evidence was that the risks of making these loans were balanced at Investment Committee meetings and that Donald Cormie or James Cormie would make the final decision to do the loan, even if they did not formally approve by signing the loan approval document. Some of these loans were Rimrock Inn, the Hudson/Wong loan (which ultimately resulted in the ownership of the Prince Royal), the Rocky Mountain Brewery, Okanagan Park and Kona. [22915-7] Fuhr testified that as this progressed the mortgage department had determined through the ongoing process of Investment Committee meetings the level of risk that it was working on and the need that it required, and in some cases, while the Investment Committee might not be involved in the granting of the loan, they were kept informed generally. He testified:

Q What was your position in terms of the officers of the companies involved and the taking of the risk? Who was taking the decision?

A It was again — generally it was the Mortgage Department and the Investment Committee that were making the decisions.

Q Were those risks weighed through the Investment Committee?

A I would have to say yes, they were.

Q The session in the Investment Committee on these large loans, these opportunities that you have characterized, was that carried on primarily by Don Cormie and James Cormie?

A Yes.

Q Would you take a position of recommendation or recommendation with qualification at these Investment Committee meetings?

A Often, I guess it would vary with the loan. Some I disagreed with almost fully. Others I, after understanding the risk that the company was prepared to take, after doing a few loans, I began to recommend them, I guess you would say, with reservations, with the reservations that I would have.

Q Some you disagreed with totally, and yet the loans were made?

A Yes.

Q Well, how did they get put forward in front of the Investment Committee? You are the mortgage manager. How did it get there unless you are recommending it?

A Well, I guess what I would say is that I presented this to Don Cormie and the Investment Committee, and they agreed that we should do the loan. I would tell them my reservations on it. [22916-8]

He testified that there were cases where Donald Cormie or James Cormie agreed in principle to the loan application, but did not sign the approval document. In those cases, the signing officers would be advised, often in response to their inquiry, that James Cormie or Donald Cormie had agreed to the loan. Upon that, they would usually sign the approval. [22918-9]

Fuhr also testified that by 1979, second mortgage lending commenced after the department checked with Deloitte Haskins & Sells and others to determine whether FIC and AIC were technically empowered to do such lending. The advice was that there was no prohibition. Fuhr explained that the department was looking for more ways to lend money and was finding it difficult to lend the amounts of money instructed by Donald Cormie and James Cormie. [22923-5]

James Cormie testified [14050-7; 14059-71; Exhibit 421; 15200-6] that between 1979 and 1982, there was an inverted yield curve, where short term deposits yielded a higher rate than long term deposits. The only place, therefore, where one could get a return high enough to cover the cost of the short term deposits was the mortgage market, and according to James Cormie, FIC and AIC tended to be forced into the mortgage market during that time.

As well, said James Cormie, the mortgage market was becoming extremely competitive, and as a result, it was extremely difficult for an institution like PGL to lend into certain segments of the mortgage market. As time progressed, management was becoming more and more "leery" of the real estate market. James Cormie said that what PGL attempted to do, therefore, was to diversify its lending into other provinces. It lent money into British Columbia, but could not completely diversify to other provinces without massive additional cost to the company. Stocks and bonds were diversified outside of Alberta and British Columbia. He testified that because Principal Group was not a primary lender, the properties were riskier, and the covenant was riskier because the loan was more leveraged. The mortgages were typically uninsured. He testified that the company would attempt to make a loan on revenue producing property first and where the property was not producing income, it would attempt to attach an income producing property to the loan. Principal Group could not compete in the conventional mortgage market, because it was highly competitive and the cost of the Group's funds was typically greater than that of the other lenders. As well, he said, Principal Group did not have offices across the country in order to achieve diversification.

James Cormie testified that the Group moved into mortgages in 1981 because it was the only investment alternative that PGL could find at that time that could yield any acceptable spread. [15060-62]

The investment in mortgages in the 1980s, said James Cormie, ran contrary to predictions made pursuant to the cycle theory. Using the theory, James Cormie and Donald Cormie predicted a drop in the real estate market in the 1980s. So the strategy was to get personal guarantees on every mortgage placed, and to lower the ratios of the mortgage loan to the appraised value. [15203-4] Using the cycle theory, he foresaw a 40% decline from the peak and then a rebound of approximately 20%, for a net 20% decline. [15205-6] Apparently it was thought that lowering lending ratios to 60% would cover the anticipated drop in value.

Donald Cormie also testified that during 1981 and 1982 there was difficulty in lending mortgage money on a competitive basis owing to the participation of the banks and trust companies in the market. By 1975 the banks had expanded their mortgage activities, forcing Principal Group to other types of loans. [16933-4]

Donald Cormie testified that generally speaking in 1981 and 1982 Principal Group charged between 2% and 2.5% over what the chartered banks charged on mortgage loans. He referred to FIC, AIC and PS&T as "third level" companies because they would not be the first approach by a borrower. He confirmed that generally speaking, the Principal Group mortgages were higher risk loans. [16951-3]

Donald Cormie testified that there was pressure in the early 1980s to lend out the dollars; that the mortgage loans made, at the time, looked like good loans, with proper spreads. There was a "great desire" to try and get the money out while what looked like good loans were available. Donald Cormie agreed that the pressure to lend the money in mortgage loans as well as the interest rate on mortgage loans was communicated by himself and James Cormie to the mortgage department. As well, while Fuhr would not be provided with specific amounts to lend , he was given an objective and that was monitored. Donald Cormie and James Cormie were also pressing Fuhr to get the funds out into loans up to the objective. [16954-73]

Donald Cormie received a quarterly list of mortgage placements showing, *inter alia*, the amounts and yields of the mortgages. He monitored mortgage volume activity weekly. Using such information, the Investment Committee instructed Fuhr as to the interest rate to be charged on mortgage loans and volume of the money to be lent. [16960-73]

Contrary to the evidence of Fuhr, Donald Cormie said that during that time (1976 to 1983) the mortgage lending practices became sloppy since there were no formal meetings of the Mortgage Committee and the lending officer would make a presentation on a one-on-one basis to the various signing officers. [16934-5] Of course, Fuhr had no power to convene such a meeting. His evidence was that he often raised the point with James Cormie and on a lesser number of occasions, with Donald Cormie.

The cycle theory also indicated to Donald Cormie that in the early 1980s, real estate would decline. There would be a 40% dip and a 20% recovery, i.e., a net 20% decline. Lending on real estate, Donald Cormie acknowledged, therefore invited a risk of the security not covering the debt; however, "at that stage, we have to rely on the experts in the [mortgage] department". [17025-34; 18935-7] Donald Cormie's view of the real estate market is further outlined in the discussions on Transaction #1.

Mortgage placements for FIC and AIC, illustrating the rapid escalation in mortgage lending, were as follows: [Exhibits 443 and 444]

	FIC	AIC
1979 Total	$14,749,996	$5,026,729
1980 Total	24,982,515	7,581,825
1981 Total	38,490,022	21,031,908
1982 Total	45,355,208	11,153,185

Many of the mortgages were large in relation to the capital base of the lender:

FIC

	June 30, 1983			June 30, 1982		
		($000,000)			($000,000)	
	No.	Amount	%	No.	Amount	%
Over $1,000,000	26	$ 42.6	34.9	21	$ 28.6	26.9
$750,000 - $1,000,000	16	13.3	10.9	8	6.8	6.4
$500,000 - $750,000	25	15.5	12.7	27	16.4	15.4
Total	67	71.4	58.5	56	51.8	48.7
Total other mortgages		50.6	41.5		54.7	51.3
Total mortgages	632	122.0	100.0		106.6	100.0

[Exhibit 550 at 128; Exhibit 606 at 3C]

AIC

	June 30, 1983	June 30, 1982		
			($000,000)	
	Amount	No.	Amount	%
Over $1,000,000	N/A	2	$ 4.643	10.5
$500,000 - $626,966	N/A	6	3.083	7.0
$250,000 - $500,000	N/A	37	12.680	28.6
Total	N/A	45	20.405	46.1
Total other mortgages			23.899	53.9
Total mortgages			44.294	100.0

[Exhibit 551 at 79; Exhibit 607 at 6]

At December 31, 1982, the portfolio was approximately composed of the following types of mortgages:

December 31, 1982
($000,000)

Type	FIC	AIC
Single Residential	$ 13.35	$ 9.25
Apartments	13.41	4.29
Hobby Farms	4.45	2.50
Hotels/Motels	16.97	1.36
Development Land	45.35	14.27
Acreages	3.54	2.47
Farms/Ranches	3.17	2.67
Retail Stores	7.25	2.42
Other Retail	4.01	—
Service Businesses	3.32	2.54
	114.82	41.77

[Source: Exhibit 526 at 62-73]

The composition of the mortgage portfolio after the cessation of mortgage lending in 1983 was as follows (as at April 30, 1984):

April 30, 1984
($000,000)

Type	FIC	AIC
Single Residential	$ 9.956	6.899
Acreages	3.560	1.469
Hobby Farms	2.395	1.273
Hotels/Motels	13.951	5.035
Land for Development	48.287	12.589
Farms/Ranches	4.817	2.946
Other	43.943	10.415
	126.909	40.626

[Source: Exhibits 550 at 203; 551 at 158]

A review authored by Hutchison, a CCA chartered accountant from the Audit Section assigned to examine the portfolios, among other things, commented that as at April 30, 1984 FIC had 38% and AIC had 31% of their respective portfolios in mortgage loans on development land, which was in his opinion, by its nature speculative and very risky. As can be seen from the above figures, the situation at December 31, 1982 was similar. Hutchison considered that mortgage loans on acreages, hobby farms and farms and ranches were also speculative and high risk. The April 30, 1984 aggregate percentages of mortgage loans of these types was 9% (FIC) and 14% (AIC). The above figures show that at December 31, 1982 the situation was similar for FIC, while AIC had reduced its holdings in these categories slightly. [Exhibit 550 at 203; Exhibit 551 at 158-9]

The mortgage rate analysis, which shows that the mortgage loans were made at above market rates and thus were of higher risk, is set out in the following table for FIC and AIC from 1979 through 1983:

			FIC/AIC					Difference	Number of FIC/AIC Mortgages Above or Below Mean Market Rate	
Term	Mortgages (3)	Date (Year) Issued	Mean Mortg. Rate (1)	Low	Median	High	Market Mean Mortg. Rate (2)	Mean	Above	Below
1 Year	2	1980	17.50		—		15.57	1.93	2	
	18	1981	20.66	16.50	21.00	23.00	18.63	2.03	15	3
	22	1982	21.02	13.00	22.00	22.00	17.71	3.31	21	1
	1	1983	22.00		—		10.75	11.25	1	
	43							2.89	39	4
3 Year	4	1979	14.87	12.50	15.50	16.00	13.37	1.50	3	1
	24	1980	17.20	15.50	16.62	22.00	14.56	2.64	22	2
	29	1981	19.91	14.75	20.50	25.00	18.50	1.41	25	4
	36	1982	22.20	21.00	22.50	22.50	18.70	3.50	36	
	1	1983	15.00		—	14.23	14.23	.77	1	
	94							2.52	87	7
5 Year	3	1979	16.66	14.75	16.25	19.00	12.70	3.96	3	
	3	1980	14.66	13.50	14.50	16.00	15.95	(1.29)		3
	3	1981	17.25	15.00	15.75	21.00	19.58	(2.33)	1	2
	9							.11	4	5

(1) Mortgage arrears report, December 31, 1983. This analysis is drawn from the arrears report. There is a potential that the mortgages contained in this report were higher risk and at higher rates than other mortgages in the portfolio.

(2) Bank of Canada Review (1 and 5 year mortgage rates). Toronto Dominion Bank (3 year rates). Monthly closing rates, where available, or average monthly rates were compared to FIC mortgages issued in that month.

(3) Sample includes all mortgages over $100,000 in principal. In total between 1979 and 1983, Woods Gordon investigated mortgages with a combined principal balance of approximately $76.60 million. Combined, FIC and AIC had outstanding mortgages of: 1979 — $55.3 million, 1980 — $82.8 million, 1981 — $128.1 million, 1982 — $172.8 million and 1983 — $159.9 million. This indicates that the sample was significant and likely covered approximately 50% of the value of outstanding mortgages.

Source: [Exhibit 606, Schedule 4; Exhibit 607, Schedule 4]

As to diversification of the portfolio, Mathes testified that as of March, 1987 87% of all mortgages were in Alberta, 11% in British Columbia and the remainder in other places. [5574] This is confirmed by Exhibit 372 at E130, showing for FIC as at December 31, 1984 86.3% in Alberta, 10.4% in British Columbia and 3.3% in other places. AIC mortgages were placed by the same department and I infer that the percentages are similar.

By memorandum dated October 26, 1983 [Exhibit 442 at 154-5] Donald Cormie directed that the companies cease the mortgage lending business for the time being. Having ceased mortgage lending, the response of the companies included FIC and AIC investing in mutual fund margin loans, and emphasizing investments in securities. Finally, it should be noted that FIC and AIC did not make insured mortgage loans. The mortgage loans were uninsured.

3. Spread and Matching

"Spread" may be defined as the measure of profitability where revenue is expressed in relationship to expense. Matching is to term or to rate. Investments ought to be matched to liabilities coming due, and to the rates owing on the liabilities plus an appropriate spread. Failure to do so may decrease spread, depending on interest rate fluctuations, and cause difficulties in funding repayment of liabilities as they come due. Matching to term and rate is critical where liabilities are of a short term, and should be done without regard to capital appreciation of the asset which may occur while it is held. Similarly, positive spread ought to be achieved without heavy reliance on trading gains; if it is not, risk increases. FIC and AIC, the evidence shows, historically suffered from narrow spreads and in the 1980s, did not emphasize matching.

Mathes testified that for the year 1985 both FIC and AIC suffered a negative spread (investment yield less cost of liabilities, before selling expenses, levies, security gains, mortgage reserves and operating expenses), while PS&T averaged a 2.5% positive spread. He said that the reason was that PS&T had lower levels of non-accrual mortgages and owned property and consistently paid lower interest rates on its deposits. Mathes gave evidence that the owned property portfolio yielded 0%. [5299-5318]

Johnson testified that the recurring spread loss problem in FIC and AIC had existed "pretty well" since the summer of 1984, although security gains in 1984 and 1985 helped to eliminate or at least reduce substantially the spread losses. In the spring of 1986, he sent Donald Cormie a position statement on both FIC and AIC with respect to the projected loss for the coming year. A later memorandum on the subject stated:

> This projected loss is basically caused by the non-performing real estate that currently yields one and a half percent, the Matrix shares which yield nothing, the PNI shares which yield us two percent, and the Athabasca shares which yield 4%. These position statements showed a significant loss and my question to you was "what is the corporate strategy with respect to eliminating or reducing this loss?" [Exhibit 293 at 292]

Johnson commented in the memorandum that when the price of oil collapsed in February, 1986 the increase in real estate sales, the optimism and the high number of phone calls with respect to real estate ceased. He continued:

> Because of this I sent you the position statements on these contract companies . . . in the spring of 1986 indicating that because of this collapse in the real estate market, we were going to be faced with a spread loss problem for a number of years to come which, during 1985, looked like it would be reduced because of increased real estate sales and its conversion to cash. [Exhibit 293 at 293]

Donald Cormie agreed that since the summer of 1984 there was a recurring loss problem in the companies, but security gains in 1984 and 1985 helped eliminate or at least reduce substantially the spread losses. [18097]

By letter dated August 27, 1986 the investment contract companies submitted a 9 month profit plan to the British Columbia regulators. [Exhibit 293 at 267-286] The plan covered the period June 30, 1986 to March 31, 1987. During all of that time, the average return on assets was approximately 3% less than the average cost of the liabilities. Note that subordinated notes were projected as costing 0% although, as I have noted elsewhere, that was not the fact. The plan showed an approximate $2,000,000 loss for the year ended 1986 for FIC and a $1,500,000 loss for the first quarter of 1987. The figures for AIC showed, for the year ended 1986, income of approximately $2,700,000, and for the first quarter of 1987, a loss of approximately $463,000. This plan shows the earning power of the assets as of the summer of 1986 and projected to the end of 1986 and into 1987 as follows:

ASSETS	FIC				AIC			
	30/01/86	30/09/86	31/12/86	31/03/87	30/01/86	30/09/86	31/12/86	31/03/87
Cash	8.0%	7.7%	7.3%	7.0%	8.0%	7.7%	7.3%	7.0%
Gov't. Bonds	10.0%	10.0%	9.9%	9.9%	10.0%	10.0%	9.9%	9.9%
Conv. Bonds	6.4%	6.4%	6.4%	6.4%	7.5%	7.5%	7.5%	7.5%
Stocks	3.3%	3.3%	3.3%	3.3%	2.4%	2.4%	2.4%	2.4%
Mortgages	13.7%	13.7%	13.7%	13.7%	13.3%	13.3%	13.3%	13.3%
Demand Loans	13.0%	12.7%	12.3%	12.0%	13.0%	12.7%	12.3%	12.0%
Real Estate	1.0%	1.0%	1.0%	1.0%	1.5%	1.5%	1.5%	1.5%
Notes	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other	—	—	—	—	—	—	—	—
TOTAL	6.8%	6.7%	6.6%	6.5%	7.0%	6.7%	6.7%	6.7%

LIABILITIES	FIC				AIC			
Term	11.4%	11.0%	10.8%	10.5%	11.5%	11.0%	10.7%	10.5%
Accum	5.3%	5.3%	5.3%	5.3%	5.4%	5.4%	5.4%	5.4%
Sub Notes	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other	—	—	—	—	—	—	—	—
Equity	—	—	—	—	—	—	—	—
TOTAL	10.2%	9.8%	9.6%	9.4%	11.6%	10.20%	9.9%	9.7%
Spread	(3.4)	(3.1)	(3.0)	(2.9)	(4.6)	(3.5)	(3.2)	(3.0)

The actual percentage return figures as at March 31, 1987 were as follows:

ASSETS	FIC	AIC
Cash	7.4	7.9
Government Bonds	9.0	9.2
Convertibles	6.7	8.4
Stocks	4.4	1.2
AHL/PNI/Mutual Funds (and for AIC only, Matrix)	4.5	3.2
Mortgages	9.1	9.6
Demand Loans	11.8	11.6
Real Estate	-4.1	1.8
Prince Royal Debenture	0.0	0.0
Notes Receivable	11.2	11.3
Other	—	—
TOTAL	5.4	6.4

LIABILITIES	FIC	AIC
Term Certificates	10.8	10.3
Accumulation Certificates	7.0	6.7
Subordinated Notes	11.4	12.1
Other	—	—
Equity	—	—
TOTAL	10.3	10.8

[Exhibit 260]

James Cormie pointed out that these March 31, 1987 returns did not include any capital gain that might be earned when an asset was disposed. He said that the yield above cost of funds in 1987 was positive on money put into collateral or margin loans, and on stocks and bonds when trading gains were accounted for. [15075-7] This evidence is demonstrative of a fundamental fact in FIC and AIC. Both companies relied on gains from the sale of securities (trading gains) to produce a spread. There is evidence, described in the section on the reasons for the financial failure of FIC and AIC, questioning the prudence of such activity for companies like FIC and AIC.

The margin or collateral loans portfolio comprised one of the assets with the highest spread in the portfolio. Margin loans were sometimes made from FIC and AIC to PGL so that PGL could buy Principal mutual funds. [6231] Margin loans were also available to customers of PS&T, FIC and AIC who wished to buy Principal mutual funds. They could borrow 50% to 70% of the value of the mutual funds and pledge as collateral their FIC or AIC term certificate or in the case of PS&T their term deposit. [7447] The margin loan rate to these customers was 3½% over prime payable monthly, which annualize to about prime plus 4%. [7449] A Principal Automatic Loan Agreement was used with respect to margin loans and an example is contained as part of Exhibit 27. PGL could borrow up to 95% of the value of the mutual funds. PGL's activity in borrowing from FIC and AIC is described elsewhere.

In the submission to the government dated June 3, 1987 [Exhibit 258] Scenario #1, contemplating the continued operation of all the companies, AIC projected a return on total assets of 5.6% to 6.5%, and a liability cost of 9% to 11%, from December 31, 1986 through to December 31, 1989 (the period of time covered in the scenario); that is, a continuing negative spread. The comparable figures for FIC were 4% to 5% return on assets, and a liability cost of 8.7% to 10.6%. According to the scenario even after security gains the deficits of FIC and AIC which were financed through raising additional PGL note money, would amount to some $190,000,000 over that time period. The losses, the scenario stated, were largely due to the high cost of funds and the low return on assets, especially non-productive real estate.

Matching was also a problem. Donald Cormie testified that in the late 1970s a matching system was in place whereby a report was produced showing maturities of investments and liabilities which was available to the investment department for the purposes of matching. [17111-2] Government examination reports for the years 1978 through 1982 noted that the investment contract companies were matched as at maturity. [FIC: Exhibit 550 at 8, 33, and 69. AIC: Exhibit 551 at 6, 27, 48 and 85] Touche Ross & Co. commented, for the year ended 1982, that while attempts had been made to consider matching, no formal or regular matching program was in place, and that PGL would be seriously mismatched in 1987 where liabilities expiring would exceed assets by approximately $45,000,000. [Exhibit 447 at 140] James Cormie testified that $40,000,000 in assets in 1986 would mature in excess of the liabilities, so that the Group had the cash one year too early. [14635-6] Touche Ross & Co. concluded that: [Exhibit 447 at 140]

> We believe that a regular review of matching of amounts and yields by year is critical to future investment decisions and this information should be summarized and made available to management on a regular basis.

For the year ended 1983, Touche Ross & Co. again commented that no formal or regular matching program was in place and made the same recommendation as for the preceding year. [Exhibit 447 at 153] James Cormie said steps were taken to put a formal program in place and they were working on matching. [14638]

One example of a matching analysis is found in the FIC Preliminary Prospectus submitted to the ASC March 29, 1985. [Exhibit 372 at E136] This document, entitled Liquid Capital Position, shows investments and investment certificates under 1 year and over 1 year for the years ended 1983 and 1984. The results are as follows:

Assets/Liabilities
($000)

	Dec. 31/83			Dec. 31/84		
	Under 1 Year	Over 1 Year	Total	Under 1 Year	Over 1 Year	Total
Investments	141,321	120,241	261,562	180,247	151,667	331,914
Liabilities	113,642	145,469	259,111	153,710	174,711	328,421
Surplus (Deficiency)	27,679	(25,228)	2,451	26,537	(23,044)	3,493

Those tables were based on an assumed realization of mortgages and real estate at book value, and contemplated redemption of $838,000 of preferred shares in the "over one-year" column. Even on those assumptions the table tends to demonstrate the poor matching position of FIC by 1982.

In a Department Review Report on the investment department dated October 18, 1984 [Exhibit 409 at 47] it was noted that for 1983, the overall spread of PGL was .04% and for 1984 .19% (cost of 11.5% term certificates included) and .28% (cost of 11.5% term certificates not included). The 11.5% term certificates were a special promotion product. [13775]

The term objectives set for matching, i.e., the term of the investment equalling the term of maturity of liability due to investors, was 80%; the actual for FIC and AIC was 60%, and for PS&T 70%. It was noted that the spread for PGL was much lower than its objective and much lower than Canada Trust, which had a spread of 2.3%. It was also noted in the report that:

> Our stock and bond investment process represents a significant area of future risk in three ways:
>
> (a) Increasing riskiness in the stocks/bonds purchased as we approach the market peak. This process could be quite inadvertent.
>
> (b) Divergence from our stock purchase strategy. That is, it is possible that we will inadvertently begin to buy stocks inconsistent with our buying strategy.
>
> (c) Dependence upon loan spread and the mutual fund fees leveraged funds investments will generate. It is necessary that we anticipate our dependence on these sources of revenue since they could diminish dramatically with a market decline. At the same time, we must be in a position to adjust to this possibility. The closed end mutual fund will offset this process to some extent. [Exhibit 409 at 51]

This quotation was put to James Cormie, who agreed that the three risks existed. The response of the company was to try to get a better concept as to how to specifically monitor the risk and then to monitor it. [13793-7]

James Cormie stated that in late 1984 or early 1985 matching became more refined, with the emphasis on rate matching. Matching to term was abandoned, apparently because the liability portfolio contained both accumulation plans and single pay plans. According to James Cormie it was not possible to match to an accumulation plan because its ultimate maturity value was dependent on the customers continuing to make payments, and therefore if single pay plans were matched, over the years the companies would become mismatched due to the accumulation factor on the accumulation plans. [13783-7]

I pause to comment at this point that this is an implausible reason for failure to match to term. As I indicated in a previous chapter, by 1984 93% of the certificate liabilities of FIC were in single pay certificates with only 6.6% being in installment certificates. I cannot accept the fact that the single pay certificates could not have been matched to term independently of the accumulation certificates.

In James Cormie's assessment, what was important was interest rates. As an example, in FIC, if rates went down, the spread would decrease because the return on the assets such as collateral loans would drop faster than would the cost of funds. Cost of funds were based on longer term liabilities

(1 to 5 years), with no demand deposits. Although James Cormie denied it, the investment contract companies were not matched to term and rate in the first place. He stated that the reason for the mismatch was because certain of the categories of the asset class could not be directly matched. As a result, assets were acquired in such mix to protect the investment contract companies in a changing rate environment; for example, long bonds (which appreciate in value when interest rates drop) could be held to protect against collateral loans (the return on which fluctuates with interest rates). [13782-91]

James Cormie testified that from 1985 through 1987, the matching objective was better achieved than in 1984. In the last 18 months of the history of FIC and AIC, there came a point where there was not much more that could be done. As an example, James Cormie said that he would buy as many long Government of Canada bonds as he could, but the biggest problem was that the real estate could not be sold. [13780-91]

Donald Cormie testified that steps were not taken to match FIC and AIC to the same standards as PS&T, and stated that matching did not have as great significance in FIC and AIC as it did for a demand deposit-taking institution. [17114-15; 19580]

Mathes concluded in April, 1984 that FIC and AIC term products were not profitable, and recommended that management either drop the rate paid on all term certificates to a rate less than or equal to the market rate, or adopt a more aggressive investment strategy emphasizing mortgages and corporate bonds. [Exhibit 409 at 60] James Cormie testified that the company did not want to drop those products completely "so we tended to lower them slightly". He acknowledged that it was probably true that if the first recommendation were followed, one would probably get very few sales. The emphasis, rather, was on investment of proceeds into such assets as the collateral loans which were, he said, extremely profitable. At the same time, he felt that the potential in the stock and bond markets was enough to counteract the difficulty. [13793-9]

Margin loans commenced in approximately mid-1982 and increased through to June 30, 1987. As stated earlier, it was a profitable investment, returning an approximate 4% spread on an annualized basis. According to James Cormie they achieved a spread of at least 4%, or 2.5 to 3% after sales and administration costs. The investment in bonds generally grew from 1980 through 1987. Investments in stocks increased to mid- 1982 and then stayed relatively constant, and James Cormie said they were very profitable. He testified that the financial picture of the companies was better between December 31, 1985 and June 30, 1987 because income-earning assets increased significantly through that time. New money coming in, he said, was being very profitably invested. [15062-7]

According to James Cormie [Exhibit 409 at 20] the total rate of return on stocks and convertible bonds for AIC over ten years was 18.8%, and for five years 21.63%. The figures for FIC were 18.88% and 21.27% respectively. The figures include capital gains.

As noted above, Mathes concluded that the worst products, in terms of profitability, were FIC and AIC term products. Donald Cormie disagreed with the assessment, for the reasons that the new margin loans were just coming into play and would give a good spread and because Mathes took into account the impact of the real estate writedowns as an ordinary expense, whereas other people would consider that as a one time occurrence. Mathes' conclusion that the term certificate products would not make money in the long run given the current investment policy was also challenged because he had not considered the impact of margin loans or the impact of the payment of the head broker income to FIC. In AIC's case, Donald Cormie asserted that Mathes failed to consider a program to invest in zero coupon bonds. He admitted, however, that the existing pool of certificates was not profitable owing to the writedowns on real estate and mortgages. [18532-42] [16298-312] The head broker fee was paid to FIC only, as it was designated the head broker with respect to the sale of mutual funds. The practice of paying it commenced in 1983; FIC had not previously received it.

The sales fee on mutual funds was 9% and charged to the client. [Exhibit 258 at 263] For every $1,000 of mutual funds sales, FIC received $27.20. [Exhibit 258 at 259] This head broker's fee in

1986 was $2,822,000. In 1986 FIC earned $28.80 per $1,000 of mutual funds sold which was changed to $27.20 at the beginning of 1987. [Exhibit 258 at 259]

FIC received the head broker's fee from the sale of mutual funds for no other reason than it provided a source of income to FIC. It was related to the fact that FIC was paying a subsidy to PCL every month. [16631] In fact PCL sold the mutual funds.

PCL was subject to capital requirements to maintain its licence. Because it did not receive the full 9% load or keep all of its sales costs — much of it having been distributed to other PGL companies — it needed to be subsidized. FIC covered all the losses of PCL. [5244]

In part of the presentation of the scenarios to the Government of the Province of Alberta on June 3, 1987, it is stated that:

> 8. **Subsidy** (FIC/PCL Intercorporate Expense/ Revenue only — not AIC)
>
> **Purpose:**
>
> FIC covers any operating deficit incurred by PCL each month, in the form of a cash subsidy. FIC defers the cost of a subsidy and writes it off over the following five years. PCL treats it as current operating income. In addition to bringing PCL into an income position so that it meets the requirements of a Broker/Dealer under the Securities Act, the subsidy reflects the facts that FIC is a distributor of the mutual funds (for which, since 1984, it has received the "admin override") and the sales force is key to FIC's operation.
>
> **Formal Agreement:**
>
> None.
>
> **Amount:**
>
> In 1986, the subsidy amortization amounted to $1,148,010 while the total subsidy actually paid to PCL was $1,347,355. [Exhibit 436 at 5-6]

The subsidy amount was paid by FIC to PCL monthly in cash and recorded as income when received by PCL. It was expensed on an amortization basis in FIC. Barefoot, the expert management consultant, indicated that he could think of no business reason for FIC to either pay the subsidy or once paid to defer or amortize it, that is to expense the subsidy over a period of time. Given that the subsidy was to be paid at all he would have preferred recording both of them in the year they were received. [35661-3]

The results are summarized as follows:

($000)

Year	PCL Income	PCL Expense	PCL Loss (Subsidized by FIC)	FIC Expense Amortization of Subsidy	FIC Head Broker Fee
1982	802	2,000	1,198	--	--
1983	1,778	2,110	332	--	2,357
1984	1,426	2,567	1,141	--	1,278
1985	1,218	2,613	1,395	--	1,317
1986	1,175	3,022	1,847	1,153	2,368

[Exhibit 258 at 261; Exhibit 272 at 12, 26, 38, 47, 71]

In the result, the head broker fee offset the PCL subsidy from the perspective of Donald Cormie. The fact remains however that PCL was the sales arm of PGL. It sold the products. It could and should have charged enough to cover the selling expenses without a subsidy. The result of the head broker fee income going to FIC in the context of the sale of mutual funds was to artificially inject income to FIC and in the result overstated the profitability of selling investment contracts.

McCutchen, who had audited the companies from 1976 until their demise with the exception of the fiscal years ended 1982 and 1983, testified that his recollection (which, he said, could be proven wrong) was that AIC's and FIC's spread was always "very close to" marginal or negative. He defined "spread" as the difference in average rate of return and average cost of funds. [24658-9]

Barefoot testified that generally, FIC and AIC paid a higher interest rate on certificates than their competitors (banks and trust companies). In some instances, the rate was comparable; in other instances, the spread was as much as 1.6% over the competition. Overall, the average difference varied between .5% and .75%. Between September, 1982 and December, 1983 the twelve month certificate offered the highest premium over the market, whereas between March, 1984 and March, 1986 the three and five year certificates were generally at a higher rate. From June, 1986 to April, 1987 that trend reversed and short-term one year certificates again offered a higher premium over the market. [35626-30] Owing to the reserve system and the treatment of sales and commission expenses, the cost for a term certificate was higher than a GIC from a trust company. [35630-1]

Barefoot noted that the trend to shorter term products was becoming apparent by the end of 1977 and testified that matching to term and rate became critical element with the move to short term products. With the shift, matching became more important than it had historically been. Moreover, he testified that matching should be done without regard to capital appreciation of the asset between the time of its acquisition and the time of its disposal. [35615-26; 35632-3]

Barefoot performed a matching analysis based on a number of assumptions: [35635-7]

(a) Cash and marketable securities were assumed to be immediately convertible at market value;

(b) Related party securities were assumed to be convertible over a period of 1 to 3 years;

(c) Mortgages were assumed to fall due on a proportionate basis over 5 years;

(d) Non-performing mortgages and real estate were assumed to be convertible evenly over 7 years at net book value for the 1985 and 1986 analyses; over 2 years at net book value for the 1979 analysis.

Barefoot testified that the assumptions were conservative, i.e., their effect was to overstate the liquidity position. [35640]

The analysis covered the position as to 1979, 1985 and 1986. Based on the above assumptions, he concluded that in 1979 FIC would be in a positive mismatch position until 1983, and overall the positive mismatch was $567,000. During that time, interest rates were rising. Accordingly the company had the ability to cash in on its assets and reinvest them in a rising market while its liabilities were locked in at lower rates. Had interest rates dropped, the position would have been less fortunate. [35636-8]

In 1985, FIC was positively mismatched for the period one year or less, and then fell into a negative mismatch position, except for liabilities coming due over four years. Overall, it had a $10,900,000 negative mismatch. For 1986, the overall negative mismatch was in excess of $46,000,000, with a $37,400,000 negative mismatch for liabilities one year or less, and a $37,000,000 mismatch for liabilities of two years.

The schedules prepared by Barefoot are reproduced in part as follows:

MATCHING — 1979
(\$000,000)

Excess (Deficiency) Assets over Liabilities

Year	FIC	AIC
1 or less	23.601	3.534
2	.958	1.208
3	3.178	1.612
4	1.787	1.140
over 4	(28.957)	(6.670)
TOTAL	.567	8.240

[Schedule 13, Exhibit 606 at 13; Schedule 13, Exhibit 607 at 17.]

MATCHING — 1985
(\$000,000)

Year	FIC	AIC
1 or less	6.232	(.378)
2	(11.913)	(4.674)
3	(27.575)	(9.080)
4	(9.295)	(.378)
over 4	31.667	11.669
TOTAL	(10.884)	(2.841)

[Schedule 14A, Exhibit 606 at 14; Schedule 14A, Exhibit 607 at 18.]

MATCHING — 1986
(\$000,000)

Year	FIC	AIC
1 or less	(37.436)	(17.512)
2	(37.151)	(6.062)
3	5.407	11.124
4	3.055	(1.909)
over 4	19.682	(2.016)
TOTAL	(46.443)	(16.375)

[Schedule 14B, Exhibit 606 at 15; Schedule 14B, Exhibit 607 at 19.]

In Barefoot's opinion, the schedules indicated that the investment contract companies could not meet their liabilities by 1985, and would be unable to meet them without either a capital injection or a significant reinvestment of one year term certificates. In 1985, FIC would have been able to meet its one year terms, but would have had some difficulty in meeting the two year terms because there was an \$11,900,000 deficiency. By 1986, FIC's deficiency had climbed on the one year terms to \$37,400,000. In 1985 and 1986, the investment contract companies were in an overall mismatched position. [35641]

Barefoot noted that the rates offered on investment contracts were generally higher than trust company and bank rates. His belief was that the company attempted to do some matching, but that it was apparent that it was not done in a formal way. In the result, he said, it was not accomplished. [35643-5]

In terms of spread [35697-702], Barefoot noted that historically trust companies attempted to achieve a 2.5% gross spread, which meant that they would try to put money out at such a rate that would yield a minimum 2.5% above the cost of funds. During the late 1970s and early 1980s some companies saw their gross spread deteriorate to approximately 1.25%, and since approximately 1983, the trend was to move back toward 2.5%. FIC achieved an average gross spread of 3.73% from 1974 until 1986. The figure includes capitalized interest on mortgages and related party income for the years 1983 through 1986. The average net spread (after deduction of sales certificate issuance expenses) was .65%. Barefoot opined that FIC exceeded the gross spread of trust companies by quite a substantial margin. However, FIC was only able to exceed industry norms through gains on the sale of securities. After elimination of non-cash income and expenses — including capitalized interest revenue (net of provision for losses), various related party income, forgiveness of fees, and re-allocation of additional credits — the net spread on a cash basis dropped from 2.91% in 1980 to .54% in 1981, and thereafter was negative. The average for the period 1974 to 1981, without Barefoot's adjustments as indicated, was .97%.

The following tables express the contract companies' spread as the difference between revenue and interest expense as a percentage of the liability base (gross spread) and after deduction of sales certificate issuance expenses as a percentage of liability base (net spread). Adjustments eliminate capitalized interest and related party gains, but do not otherwise account for mortgage and owned property write downs.

FIRST INVESTORS CORPORATION LTD.

GROSS AND NET SPREAD — ADJUSTED

(Percent)

	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974
Net Spread (Sch. 21)	1.40	(1.19)	1.43	0.94	(1.92)	0.54	2.91	2.80	2.75	(0.41)	(0.54)	(0.30)	0.02
Less: Sch. 20 adjustments	5.77	6.69	10.06	4.06	3.50								
Net Spread — cash basis	(4.37)	(7.88)	(8.63)	(3.12)	(5.42)	0.54	2.91	2.80	2.75	(0.41)	(0.54)	(0.30)	0.02
Gross Spread	3.57	.98	3.72	3.62	1.36	3.86	5.37	5.67	6.13	3.92	3.06	3.56	3.73
Less: Sch. 20 adjustments	5.77	6.69	10.06	4.06	3.50								
Gross Spread — cash basis	(2.20)	(5.71)	(6.34)	(0.44)	(2.14)	3.86	5.37	5.67	6.13	3.92	3.06	3.56	3.73
Gross Spread — Net of Security Gains	(4.24)	(8.44)	(7.65)	(2.04)	(2.96)	0.72	0.28	1.84	2.33	2.68	2.90	3.27	3.89
Net Spread — Net of Security Gains	(6.41)	(10.61)	(9.94)	(4.72)	(6.24)	(2.60)	(2.18)	(1.03)	(1.05)	(1.65)	(0.70)	(0.59)	.18

[Source: Exhibit 606, Schedules 20, 21 and 21A. Sums net of security gains are calculated from the Schedules by deducting gains on non-related securities.]

ASSOCIATED INVESTORS OF CANADA LTD.

GROSS AND NET SPREAD — ADJUSTED

(Percent)

	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976*	1975	1974
Net Spread (Sch. 21)	(0.14)	(1.52)	0.86	0.55	(1.44)	(0.15)	0.23	0.51	(0.40)	(0.07)	8.69	1.28	0.66
Less: Sch. 20 adjustments	6.49	6.94	8.93	4.43	3.64								
Net Spread — cash basis	(6.63)	(8.46)	(8.07)	(3.88)	(5.08)	(0.15)	0.23	0.51	(0.40)	(0.07)	8.69	1.28	0.66
Gross Spread	1.59	0.33	3.00	2.71	1.53	2.98	2.16	2.70	2.61	2.94	11.99	3.66	2.70
Less: Sch. 20 adjustments	6.49	6.94	8.93	4.43	3.64								
Gross Spread cash basis	(4.90)	(6.61)	(5.93)	(1.72)	(2.11)	2.98	2.16	2.70	2.61	2.94	11.99	3.66	2.70
Gross Spread — Net of Security Gain	(7.76)	(10.12)	(7.27)	(3.22)	(3.04)	0.31	(1.71)	0.15	1.51	2.94	12.26	3.62	3.10
Net Spread — Net of Security Gains	(9.49)	(11.97)	(9.41)	(5.38)	(6.01)	(2.82)	(3.64)	(2.04)	(1.50)	(0.07)	8.96	1.24	1.06

* Includes extraordinary gain on the sale of land of 8.32%

[Source: Exhibit 607, Schedules 20, 21 and 21A. Sums net of security gains are calculated from the Schedules by deducting gains on non-related securities.]

Barefoot concluded that on an adjusted basis, the company earned a below market rate of return on its investments. [35703] While security gains were an important element of its operations, there was significant variance in the security gains over the years, which created an element of risk in being able to sustain the operation over the longer term. He testified as follows:

> Because mortgage interest was a major component of revenue, it was important that that portfolio generate substantial income. Unfortunately, because a large majority of it wasn't cash, again it created a cash flow strain on the company.
>
> Certainly the security gains of FIC were an important element of its operating picture. Unfortunately, though, there's significant variability in the security gains. In some years the company did exceptionally well; in other years they did not. As a result, the variability creates an element of risk in being able to sustain an operation over a longer term. [35703-4]

According to the above tables, FIC and AIC, after elimination of security gains, had not met industry norms since 1977. The security gain figures (although they are reported separately in the audited financial statements) may include interest income and therefore cannot be taken as absolute. [35650] Even so, the trend is apparent.

Barefoot compared FIC and AIC to 7 different trust companies. In his opinion, once the administration fees and levies were forgiven, FIC's and AIC's expenses were comparable to the other companies, with the exception of 1982. The operating results were adjusted to deduct capitalized mortgage interest, non-cash related party dividends, non-cash gains on certain related party sales, an income adjustment for unclaimed certificate balances, forgiven interest and administration levies which had been paid in cash, capitalized carrying charges, and the income effect of the change in practice of declaring additional credits. After the adjustment, AIC and FIC were significantly below industry norms, both in terms of gross and net spread. [35704-7; Exhibit 606 at 27]

Barefoot also noted that security gains as a percentage of revenue for FIC for the years 1982 through 1986 were significantly above 3 other trust companies chosen for comparative purposes. He prepared the following table showing security gains as a percentage of revenue: [Exhibit 606 at 27A; Exhibit 607 at 34; 35707-8]

	1986	1985	1984	1983	1982
FIC	43.51	21.84	8.81	9.58	5.11
AIC	48.31	26.86	9.43	9.74	8.75
Eaton Trust	.09	.08	--	.94	.34
Yorkshire Trust	--	1.74	.73	3.47	.31
Victoria & Grey Trust	--	--	1.51	2.21	1.45

Barefoot concluded that it was critical that FIC and AIC do consistently well in the securities market, given the nature of the income return on assets.

The gain on securities for FIC, as a percentage return on assets, tended to fluctuate from 1980 through 1986, from a high of 10.57% to a low of 2.59%. While the 1986 gain was 18.7%, it is reduced to 5.97% after elimination of security gains on related party assets. Thus, while the total return on assets for 1986 was 14.12%, it is reduced to 9.94% after elimination of related party gains. [35651-4] Corresponding figures for AIC are not in evidence; however, AIC booked large related party gains in 1986 as well. [Exhibit 607, Schedule 21A]

Barefoot noted that in the case of AIC, its net income was consistently lower than that of FIC and experienced losses from 1977 onward, with the exception of small profits in 1979 and 1984. [35896] Before accounting adjustments, the average gross spread for this company was 2.41%, and the average net spread was .03%. As with FIC, net spread became negative after 1980 on an adjusted basis. After deduction of security gains, the gross spread was significantly lower than that of other financial institutions.

4. Conclusions

On the basis of the foregoing, the evidence tends to show:

(1) FIC and AIC experienced a cost of funds higher than comparable trust company rates for similar products.

(2) Sales and administration expenses charged to FIC and AIC exacerbated the high cost of funds and reduced the net spreads.

(3) The corporate policy, as directed by Donald Cormie and James Cormie, on mortgage lending was to make higher rate, higher risk loans, especially in 1981 and 1982.

(4) Geographic diversification in mortgage lending was not vigorously pursued, with concentration left in Alberta and to a lesser extent, British Columbia.

(5) Gains on sale of securities was a significant investment policy used to counteract marginal and negative spreads. With the loss of earning power on the mortgage portfolio, corporate policy as established by James Cormie and Donald Cormie emphasized gains in the rising stock market, higher rate margin loans, and convertible bonds.

(6) Retail lending (consumer loans) was non-existent except for margin loans;

(7) Matching to term was not regarded as important, nor was it done.

(8) Matching to rate was a consideration and apparently became more refined commencing in 1984. However, rates paid on new money and rollovers of maturing certificates were above the overall return on assets including mortgages and real estate. New money was profitably

invested only when compared to the asset yield excluding non-performing mortgages and owned property. The emphasis on collateral or margin loans as a home for new money itself was risky. As James Cormie said, falling rates would immediately affect the return on these floating rate loans.

D. SALARIES, BONUSES, COMPENSATION TO CORMIE FAMILY MEMBERS AND THE PEP PLAN

1. Introduction

There is much evidence as to the executive salary compensation, bonuses and benefits to Cormie family members and others. The compensation to non-family executives and to James Cormie, John Cormie and Donald Cormie by way of salary and interest-free loans was justifiable. As indicated below, some of the salaries to some family members were not justifiable, nor was the forgiveness of the loan to Christa Petracca justifiable.

2. Salaries to Non-Executive Family Members

Eivor Cormie

Eivor Cormie, wife of Donald Cormie, was paid $275,000 August 1, 1986 to August 31, 1987 by CSI. [Exhibit 337 at 68] CSI was the parent of PGL at that time. According to Donald Cormie, he made the decision to pay Eivor Cormie this sum of money because a cap had been put on the amount paid to EL&F by PGL of $30,000 per month. Further, he said that if EL&F had charged $5 per thousand, it would have been owed $1,000,000 that year. [20379] Donald Cormie stated there would be no cap on the EL&F payment of $30,000 per month "if it hadn't been for this", i.e., the $275,000 salary. [20380]

Allison Cormie

Allison Cormie was paid $120,000 by PGL from August 1, 1986 to August 31, 1987. [Exhibit 337 at 66] As discussed above, she did her carbon dating and prediction of the economic cycle work for PGL. There is, however, no paper writing purportedly authored by Allison Cormie in terms of an analysis of economic trends or cycles *per se*. Exhibit 508 was tendered to show her qualifications only. [22453-54] Her qualifications seem to indicate, at least from the exhibit, that her expertise is in the area of a technique to determine past climates using stable isotope ratios in bone.

Bruce Cormie, Neil Cormie

The evidence tends to show that Bruce Cormie and Neil Cormie provided services as employees of CSI and PGL and in the case of Neil Cormie also as an employee of Matrix. [19049-52]

Eivor Cormie, Jr.

Eivor Cormie, Jr., was paid by CSI according to Exhibit 337 at 66 the sum of $21,500 from August 1, 1986, to August 31, 1987, and she came into the Securities Department of PGL. [18239]

Robert Cormie

Donald Cormie said that Robert Cormie "did anything that was required and to some extent that would be income splitting". [18240] No explanation was given to the effect that Robert Cormie did any work for CSI. [18240]

Conclusions

There is no evidence that Eivor Cormie did anything to earn the $275,000. Therefore, the evidence tends to show that the payment to Eivor Cormie by CSI was a fraudulent and dishonest expense on the part of CSI, made at the direction of Donald Cormie.

The evidence tends to show that Allison Cormie's salary of $120,000 paid by PGL for the period August 1, 1986 to August 31, 1987 was fraudulent and dishonest. It appeared to be a legitimate expense of PGL when it was not. They were gifts bestowed on family members by the majority owner of the companies, Donald Cormie.

The evidence tends to show that Bruce Cormie, Neil Cormie, Eivor Cormie Jr. and Robert Cormie performed services for the corporations referred to and were legitimately compensated.

3. Salaries and Benefits to Executives

Salaries paid to executives, whether they be family or non-family are set out in the evidence in Exhibit 337 and elsewhere. In the case of John Cormie, James Cormie, Donald Cormie, Petracca, Johnson, Pearce, Marlin and Patrick, all of whom comprised the senior executive level of PGL from 1984 to 1987, the evidence tends to show that the salaries were reasonable and properly paid.

Other benefits included interest-free housing loans made to, amongst others, James Cormie, John Cormie, Eivor Cormie Jr., Neil Cormie and Petracca. [Exhibit 337 at 24-28]

As set forth in Exhibit 337 at 24 through 28, there were detailed repayment schedules in respect of the interest-free housing loans which repayment schedules were adhered to in the case of each person.

Johnson, the Vice-President of Finance for PGL from November 1, 1984 to June, 1987, also had an interest-free loan. He negotiated the forgiveness of the loan at the rate of $25,000 per year. [18249] The reason for the forgiveness of his loan was because Johnson stated that his services were much more valuable than his salary indicated and he might be forced to leave unless he received the additional compensation ($18,248). The evidence tends to show that this forgiveness was reasonable in the circumstances.

The housing loan and the bonus arrangements in respect of Petracca and its relation to the joint government of Canada/Alberta grants pertaining to real estate was the subject of considerable evidence and is deserving of detailed comment.

Petracca was advanced $395,000 by PGL from April 4, 1987 to July 17, 1987 and the balance owing to PGL as at August 10, 1987 was in excess of $500,000. The loan was interest-free. [Exhibit 337 at 28]

The evidence with respect to Petracca's bonus in 1987 was that she was to receive 10% of any amount received as a government grant in lieu of other bonus arrangements on the real estate. [Exhibit 369 at 1041]

Government grants were to be received in respect to the real estate development of the Rimrock Inn at Banff, Alberta. The total anticipated grants in respect of all of the real estate developments on which Petracca was working was $2,350,000 and her bonus was to be 10% thereof or $235,000 in lieu of any other bonus arrangements.

According to the evidence of Donald Cormie, the advances on Petracca's loan were related to the anticipated receipt of the government grant money.

The evidence on these matters given by Donald Cormie was that the $75,000 advanced to Petracca on May 8, 1987 was intended to be an advance against 10% of the estimated government grant money of $2,350,000. Donald Cormie in his notes on one side of 1039 of Exhibit 369 has subtracted $75,000 from $235,000, leaving the remainder of $160,000 and confirmed that in his evidence. [18251] The notes are titled "Funds to house" and state as follows:

	$1,900,000	Grant
	$ 450,000	Grant
	$2,350,000	
	$235,000	"Estimated bonus on money *received* to be *credited* against *house mortgage*"
ADVANCE	$ 75,000	
BAL	$160,000	

This handwritten memorandum was made May 6, 1987 and Donald Cormie's evidence was that the $75,000 was an advance against the anticipated receipt of the grant monies and that the grant monies when received were to be applied against the housing loan. [18251]

A memorandum relating to the bonus on real estate [Exhibit 369 at 1040] was backdated to June 22, 1987. Another memorandum [Exhibit 369 at 1041] was also dated June 22, 1987 and was not backdated. A third memorandum [Exhibit 456] was dated July 9, 1987. In fact, the backdated memorandum was prepared after July 9, 1987 and was in fact a revision of the July 9, 1987 memorandum.

The first June 22, 1987 memorandum from Donald Cormie to Nicholson [Exhibit 369 at 1041] confirmed that Petracca was to receive a bonus of 10% of any amount received as grants in lieu of other bonus arrangements on the real estate. It stated:

> This bonus should be paid by First Investors Corporation Ltd. in favour of Principal Group Limited and sent to Diane Stefanski who will apply it on the loan advance Christa has from Principal Group.

On May 8, 1987 $75,000 was advanced to Petracca from PGL.

Donald Cormie said that Petracca complained about the arrangement that the 10% of the grants would be paid in lieu of a bonus around July 9, 1987. [18257] In the result the July 9, 1987 memorandum was written from Donald Cormie to Christa Petracca.

At some date subsequent to July 9, 1987 the backdated memorandum of June 22, 1987 was prepared. The two memoranda are almost identical but for the following significant differences. The July 9, 1987 memorandum states: [Exhibit 456]

> We agreed that your bonus would be paid to you by FIC and AIC at a rate equal to 10% of the cash coming in on the grants to a maximum of $250,000.00.

The backdated memorandum states: [Exhibit 369 at 1040]

> We agreed that your bonus would be paid to you by the Group . . .

meaning PGL.

Donald Cormie denied contemplating that the agreement was that FIC would pay the bonus on June 22, 1987. [18263] The backdated memorandum indicates that if the "appropriate company" does not pay the bonus, "it must be paid by Principal Group Ltd." According to Exhibit 369 at 579 by letter dated June 15, 1987 Marquette Realty and Development Limited, the subsidiary of FIC formed to develop the Rimrock Inn in Banff received $321,162.60 to be used to undertake the expansion and modernization of the Rimrock pursuant to a joint federal/provincial tourism agreement. In addition, the sum of $12,400 was received with respect to a marketing study. The evidence is therefore that the sum of approximately $333,500 in grant money was received by FIC or its subsidiary prior to June 30, 1987.

Donald Cormie said that it was his decision to backdate the memorandum [Exhibit 369 at 1040] to June 22, 1987 [18271] and denied that it was backdated because he wanted it to appear that it had been done on a date which in fact it had not been done, namely June 22, 1987. [18272]

The evidence tends to show that Donald Cormie was attempting to make it appear as if the memorandum had been done on June 22, 1987 and was not simply backdating the memorandum. The evidence tends to show that Donald Cormie acted dishonestly and fraudulently in dating the memorandum June 22, 1987 with a view to having PGL make a valid payment of funds to Petracca so as to avoid the possibility that Petracca may not be paid from FIC and AIC which were by then (July 9, 1987) under the control of the manager, Coopers & Lybrand Limited.

Petracca also received a benefit through the forgiveness of a loan against her house. By letter dated July 23, 1987 [Exhibit 369 at 1042] Donald Cormie wrote Petracca and said:

> As an inducement to have you stay and work out the existing problems, at least to year end, we are prepared to pay you a bonus by discharging the loan against your house, with no further payment, effective immediately. You will, however, remit $200,000.00 on the sale of your condo whereupon that mortgage will be discharged.

Similar letters were dispatched to James Cormie and John Cormie and their house mortgages were discharged. [18266]

In Exhibit 337 at 28, the balance shown on Petracca's loan is calculated by Stefanski at $510,557.57 as of July 17, 1987. Thus, the house loan forgiveness was in excess of $300,000.

The evidence of Donald Cormie was that Petracca never told him she was going to leave but was talking about other jobs and whether she had a future with PGL. [18268-9] One of the most telling answers of Donald Cormie in relation to his view of cash payments is at 18269, where he says:

> Q That prompted you to make this arrangement?
>
> A Yes, I felt that since Johnson had left, and Rob Pearce was talking to some of the people, some of the proposed buyers, I was kind of panicky to keep a few C.A.'s around, so I thought that I could do that *without using cash* (emphasis added).

The evidence tends to show that Donald Cormie avoided using cash unless payments were being made to the upstairs companies or to family members. Petracca's mortgage was discharged by instrument dated August 5, 1987. [Exhibit 383] Donald Cormie indicates that he told Marlin that by signing the discharge of the mortgage, PGL was forgiving $300,000 plus. [18270] Marlin's evidence was that he was not told.

I do not accept Donald Cormie's evidence that he did not contemplate bankruptcy in late July, 1987 when he forgave the housing loans. The evidence tends to show that the forgiveness of the Petracca housing loans by Donald Cormie in late July, 1987 was fraudulent and dishonest.

4. The PEP Plan

The Principal Employees Plan was in the later years a plan whereby PGL employees and relatives of the Cormie family could invest and be paid a rate of return in excess of market rates, namely 4% over the going rate. [18275] On July 28, 1987 all plan-holders were paid out. The pay out exceeded $1,336,000. PGL declared bankruptcy on August 14, 1987.

The plan was such that if an employee ceased to be employed, the employee or his relative would be paid out. [18275] If an employee did not cease his employment, he did not have the right to demand payout and be paid out. [18276] A number of employees tried to get their money out in the spring of 1987 [18277] and Donald Cormie was told that they were getting nervous and wanted to get their money out. [18277]

Donald Cormie indicated that he had an interest in keeping the employees with him because prospective buyers valued the company as a going concern on a per employee basis [18277] and that he was concerned that some of them might want to quit just to get their money out. [18278] It was Donald Cormie that took the decision to pay everybody out July 28, 1987 and he took the decision to pay the PEP plan out in its entirety. [18278] The amounts exceeding $500 which were paid out aggregated $1,336,879.66. [Exhibit 337 at 76]

Donald Cormie denied taking this decision, and making the payout in consequence, knowing that PGL was going to declare bankruptcy. He said that he did not contemplate bankruptcy before about August 9, 1987, perhaps August 8. [18282]

There were many members of the PEP Plan who were not employees or relatives of employees; rather, they were members of the Cormie family. For example, Donald Cormie's brother and sister were included. [18280] Donald Cormie admitted that their desire to be paid out would not affect the sale price that could be realized in any sale to a prospective buyer. [18280]

I do not accept the evidence of Donald Cormie that he did not contemplate bankruptcy when he directed the repayment of the PEP Plan July 28, 1987. The evidence tends to show that the repayment of the PEP Plan at that time was dishonest and fraudulent.

VI. MANAGEMENT RESPONSE TO ECONOMIC PROBLEMS

A. INTRODUCTION

The evidence tends to show that FIC and AIC were insolvent, in that their liabilities exceeded their assets, and at risk of failure by December 31, 1983. Pressure by the Alberta regulators had intensified early in 1984 over the value of mortgages, owned properties, and certain debentures. PS&T was under pressure from CDIC over the value of its mortgages and owned properties. Management believed that CDIC pressure, while directed at PS&T, might prejudice the carrying values of certain jointly held mortgages and owned properties in the books of FIC and AIC. In early May, 1984 the Alberta regulators — as well as Donald Cormie and Marlin — received the FIC and AIC financial statements audited by Touche Ross & Co. The financial statements showed large contingent losses on mortgage loans. In fact, FIC and AIC were insolvent. It was becoming apparent by early 1984 that there were serious problems in the mortgage and owned property portfolios. All of this was known to both Donald Cormie and Marlin.

Thereafter, actions spoke louder than words. The evidence tends to show that FIC and AIC, at the instance of Donald Cormie and with the concurrence and participation of Marlin, embarked on a strategy designed to cover up their problems. Assets were moved about various companies in Principal Group and other affiliates for the purpose, the evidence tends to show, of covering up the problems of FIC and AIC. Often the effect, the evidence tends to show, was to prejudice or disregard the interests of FIC and AIC. The evidence also tends to show that during this same time period, 1984 to 1987, certain assets were moved beyond Principal Group for the purpose of saving them from being captured by an insolvency in Principal Group.

The main tool to advance the purpose of covering up problems was the intercorporate transaction. It could be used for either or both of the following 2 purposes:

1. Preserving value. An affiliate would accept a transfer of assets of questionable value at book or even higher value. In return it would issue debt or equity. In this way, assets of questionable value became once removed from their original owner. Any excess value in the new owner, the affiliate, could support soft value of the acquired asset. Often the equity was difficult to value. It consisted of preferred shares or thinly traded common shares. It was not, of course, a definite parcel of real estate that could be appraised. Thus the shares of the affiliate were less likely to be written down than the soft asset. There was, as it were, room to maneuver.
2. Booking gains. An affiliate would act as in 1 *supra* but in this instance the purpose was to realize a gain. Since a non-affiliate would not pay as much for the asset, the gains were most often, the evidence tends to show, fictitious.

Another aspect of affiliates dealing on favourable terms with other affiliates was collateral loans. PGL was able to borrow money on very favourable terms from FIC and AIC for the purpose of investing in Principal mutual funds. Thus funds were deployed for investment in affiliates. In this type of case the investment was profitable, but the risk was unacceptable.

Another tool to achieve the objective was the no risk third party. By guaranteeing a third party some gain and assuring it of no-risk, transactions much similar to those with affiliates were carried out again to isolate assets of questionable value in a new borrower or buyer, or to create what the evidence tends to show were fictitious gains, or for both purposes. The third party transactions were more expensive than those with affiliates: favourable financing that the third party could use for other purposes was granted, or a fee was paid, or an option or other incentive was granted.

Other transactions were designed to justify earlier ones or deflect criticism from them.

The drive for profitability and capital also resulted in use of the resources of FIC and AIC for collateral purposes which resulted in no real — or only speculative — benefit.

The evidence tends to show that accounting policies and the manner of financial presentation were brought in aid of presenting the best picture possible. But behind the scene, the evidence tends to show, many accounting gains were not real, full disclosure of intercorporate transactions and accounting manipulations was not made and desperate attempts were made to develop foreclosed prop erties beyond what they in nature were when originally mortgaged, with the hope of selling them at a profit to offset rising losses on other foreclosed properties.

Occasionally money in very large amounts was paid outside the Group to complete transactions. And in one case, where the Alberta regulators insisted that PGL cure the harm it had done to FIC, a large amount of promissory note money taken in from the public by PGL was used to pay FIC.

As noted in chapter VIII, FIC and AIC had agreed in 1975 not to do any more intercorporate transactions except with the Superintendent's consent. That agreement was known to Marlin and Donald Cormie. It was never terminated. Yet commencing in 1984 numerous intercorporate transactions were entered into, in particular many of those described herein, as well as the lending of money to PGL secured by mutual fund units. As I have noted above, only affiliates and certain third parties could or would deal with these companies on sufficiently favourable terms to forward the objectives.

The trustee in bankruptcy of PGL, J. Stephens Allan of Collins Barrow Limited, testified that by December 31, 1983, based on a review of the financial statements, PGL was arguably insolvent because liabilities exceeded assets. The transfer of PSML to CSL in August, 1984 in his opinion confirmed PGL's insolvency and if there were still argument about it, the injection of $11,300,000 into FIC on December 17, 1984, subordinated to the claims of other creditors of FIC, eliminated any doubt. [36116-8; 36128-38; 36142-3]

Similarly, the evidence of Peter Schenkelberg, also of Collins Barrow Limited, was that as of December 31, 1983 PGL would have suffered a deficit of assets to liabilities of between $3,500,000 and $6,500,000 had it ceased operating at that time [Exhibit 611 at 1 to 11; 35924-37], and that it suffered a further deterioration of more than $40,000,000 over the next 2½ years. [Exhibit 611 at 12; 35937-42; 36145-51] During that time, millions of dollars of intercorporate gains were booked which were not, the evidence tends to show, a true reflection of PGL's operation and which were artificial. [Exhibit 611 at 93-4; 35940; 36138-9]

The substantially deteriorated financial condition of PGL, as will be seen, motivated some of the transactions described. As will become apparent, the conditions of FIC and AIC, particularly that of their mortgage and owned property portfolios, also substantially deteriorated from 1984 through 1987.

Donald Cormie gave the following evidence: [18542-3]

> Q Did you feel you were making progress in solving the problems of FIC and AIC between 1984 and 1987?
>
> A Oh, yes, I thought the companies were in much better shape in '87 than they were in '84.
>
> Q Why is that, sir?
>
> THE INSPECTOR:
>
> What month of '87?
>
> A That would have been right up until the major write-down occurring, which was about April, May of '87.

THE INSPECTOR:

When?

A About April or May of '87 was when the $33 million --

THE INSPECTOR:

And you thought it was as good then as it was in '84?

A Yes, I thought the companies were in better shape.

THE INSPECTOR:

Better shape?

A At that time than they were in 1984 because they were moving into strong liquid-type areas.

Again at 19137:

Q Did you feel that the problems in 1987 were unique from what you had experienced in 1983 or 1984?

A No, I thought the situation was vastly improving.

As noted elsewhere, Donald Cormie in fact was in agreement with or at least did not disagree with his consultants, Ryan and Agrios, that in the Spring of 1987 FIC and AIC were not viable. I can only conclude that Donald Cormie has admitted that he knew in 1984 that FIC and AIC were not viable and indeed on the brink of insolvency. His counsel argued that I ought not to relate these two pieces of evidence to form a conclusion. I cannot accept that a witness might give some evidence for one purpose and conflicting evidence for another. In any case, on the evidence of the December 31, 1983 FIC and AIC audited financial statements, and considering the facts of the intercorporate transactions commencing in 1984 (Transactions #1, #2 and #3) and of the regulatory pressures commencing in January, 1984 and continuing through that year, I am satisfied that on the balance of probabilities, Donald Cormie knew there was a high risk of PGL and its subsidiaries FIC, AIC and PS&T failing. Similarly, I am satisfied that Marlin knew there was a high risk of failure, particularly because he dealt directly with the Alberta regulators and participated in the intercorporate transactions.

The evidence tends to show a plan to delay public and regulatory recognition and knowledge that PGL, FIC and AIC were on the verge of insolvency and later were insolvent. This was done by:

1. Adopting aggressive accounting policies designed to accelerate income recognition and to defer recognition of losses;
2. Hiding losses and preventing accounting recognition thereof (so the evidence tends to show) through the use of intercorporate transactions and risk free third party transaction;
3. Creating what the evidence tends to show were paper gains of no real substance through intercorporate transactions with affiliates and the manipulation of accounting records; and,
4. "Creating value" where less or none existed before in relation to foreclosed properties and other assets such as the shares of Matrix.

The gains and value thus created and losses so avoided were often reflected in the consolidated operating results of PGL which were, in one fashion or another, portrayed in the 1984 Annual Report and 1985 Annual Review. Thus public and sales representative confidence could be maintained and more money could be taken in to fund a crippled empire until it might heal. Profit and capital could be shown to the Alberta regulators, who might either accept the portrayal of the operating results of FIC and AIC or be persuaded not to do anything drastic in response to the true state of affairs.

The practices were most often adopted at Donald Cormie's instance, and often with concurrence or participation of any or all of Marlin, James Cormie and John Cormie. All of them were aware of the strategy.

It must always be recognized that CSL/CSI and most of their subsidiaries are private corporations. GAAP allows a range of accounting policies, some less conservative than others. Adoption of one over the other is not necessarily fraudulent or dishonest. Similarly so in the case of working out problem loans or choosing to create an accounting gain recognized by GAAP. Similarly, there is nothing wrong with members of a Group acting in harmony and co-operation while realizing on the benefits of economies of scale. Each individual case must be assessed on its own merits. In some of the instances which follow I have discovered evidence tending to show fraudulent or dishonest conduct. In other instances I have discovered evidence tending to show oppressive conduct, or that which was unfairly prejudicial to or which unfairly disregarded the interests of security holders. I have therefore reported such instances. In still other instances not in themselves constituting such conduct, I discovered evidence tending to show the larger plan to hide insolvency and present a false picture of the financial condition.

In these companies the entirety of the foregoing types of activity, coupled with the concurrent publication of what the evidence tends to show was misleading information concerning the financial condition of the Principal Group, is evidence tending to show a fraudulent design. That design was to maintain PGL, FIC and AIC as long as possible while hoping for — or dreaming of — some economic recovery which might cure all the mistakes, while continuing to take money in from the public without disclosure — and indeed with active concealment — of the true state of affairs and while moving desirable assets to the so-called "upstairs" companies, converting the debt due from those companies from interest bearing to interest free and planning ultimately to eliminate that debt through the use of the resources of PSML. Therefore I have reported all such activity.

B. CERTAIN SIGNIFICANT TRANSACTIONS

Through my Investigation I gathered evidence concerning a number of transactions. For ease of reference, certain of those transactions were numbered and most of the relevant documentary evidence concerning each was gathered together in a single exhibit. The transactions are referred to herein in the same fashion as in the evidence, that is, by transaction number. Diagrams of these transactions were also in evidence before me. Some of them are reproduced near the end of my Report.

TRANSACTION #1

PS&T, FIC and AIC had in the past participated in joint mortgage lending activity. By 1984, they jointly held mortgages and owned properties, the latter having been acquired through foreclosure of joint loans.

Effective March 23, 1984 (but in fact sometime after March 28, 1984: Exhibit 280, Tab 2), FIC and AIC purchased the interest of PS&T in 4 jointly owned properties (throughout the within discussion of Transaction #1 referred to as the "Properties") and 19 jointly owned mortgages (throughout the within discussion of Transaction #1 referred to as the "Mortgages"). The Properties had an aggregate book value of $9,644,761. The Mortgages had an aggregate book value of $56,129,080. All of the Mortgages were in default. Donald Cormie was advised by the mortgage manager that he expected FIC, AIC and PS&T would have to acquire through foreclosure proceedings the properties over which the Mortgages had been granted, 2 of them within days of March 28, 1984. Of the aggregate balances owing under the Mortgages, approximately 23% ($12,926,359) consisted of principal and interest payments due but in arrears. [Exhibit 280]

PS&T's interest in the Mortgages and Properties had a book value of $23,245,129. FIC and AIC purchased PS&T's entire interest at its book value for cash: AIC purchased one mortgage for $691,474; FIC acquired all the Properties and the other 18 Mortgages for $22,553,655. The book value represented the total principal and interest (accrued until the time of foreclosure in the case of the Properties) due to the lender as at March 23, 1984. The book value of the Mortgages and of each individual Property (as noted elsewhere, owned properties as a group were carried at the lower of cost and market value as at December 31, 1983) did not equate to market value as at March 23, 1984.

As a result of the discrepancy between book and market value, FIC and AIC suffered an immediate loss on the transaction. Estimates of the loss were as follows:

	Touche Ross & Co. December 31, 1983	**CDIC December 31, 1983**	**Superintendent of Insurance March 23, 1984**
Mortgages	$4,515,000	$5,755,000	$ 9,800,000
Owned Properties	0	0	1,500,000
General Reserve	—	510,000	—
	$4,515,000 (1)	$6,265,000 (2)	$11,300,000 (3)

(1) Exhibit 526 at 56-7; Exhibit 364 at 41. Exhibit 526 records the loss as $1,050,000 and the exposure to loss as $3,500,000 for a total of $4,550,000. Exhibit 364 records the exposure as $4,515,000, while Exhibit 272 records it as $4,600,000. The differences among the figures are not material for my purposes. The general reserve figure in this case ($400,000) is included in the mortgage balance as it is known to be applicable only to the mortgages. The entire loss was suffered by FIC.

(2) Exhibit 571 at 929-30; Exhibit 280. AIC's portion of the loss was $100,000; the balance was attributable to FIC.

(3) Exhibit 280. AIC's portion of the loss was $250,000; the balance is attributable to FIC.

The audited financial statements of PS&T for the year ended December 31, 1983, dated April 19, 1984, stated as follows: [Exhibit 277 at 40]

> 7. Contingencies
>
> It is the policy of the Company to provide an allowance from income to meet future general and exceptional losses arising from the Company's mortgage portfolio. The cumulative allowance for anticipated losses is $1,483,107. The amount of the reserve is a discretionary matter, as judged necessary by its directors and management, based on their knowledge of the Company's affairs and their assessment of the economic conditions of the provinces (mainly Alberta and British Columbia) where the current security for the mortgages is located. Because of the complexities of the real estate market, and the economic uncertainties surrounding the underlying values and the present undeterminable value of collateral securities to the mortgages, an estimated additional exposure of $5,100,000 exists if current market levels represent a permanent, rather than a temporary, decline in value. The additional exposure to the Company, after having its interest in jointly held mortgages and owned property tendered out subsequent to the year end, as described in Note 6(b), is reduced from $5,100,000 to $585,000.

This note demonstrates that the sale by PS&T of its interests in the Properties and Mortgages by this transaction virtually eliminated PS&T's contingency for losses on mortgages.

I note that in the statement quoted from PS&T's audited financial statements, the interests were said to be "tendered out" by PS&T.

The boards of directors of AIC and FIC, in each case Marlin and Espenberg, ratified this acquisition on April 16, 1984.

In December, 1984, at the insistence of the Superintendent of Insurance, PGL loaned $11,300,000 cash to FIC to "cure" the harm done by the transaction. This loan bore interest at the Royal Bank prime rate plus 2 ½% per annum. [Exhibit 611, Appendix 5; Exhibit 280]

The $11,300,000 loan was evidenced by 2 subordinated promissory notes made by FIC in favour of PGL: one dated December 28, 1984 in the amount of $6,300,000; the other dated December 17, 1984 in the amount of $5,000,000. Each promissory note provided that neither principal nor interest would be paid without the prior written consent of the Superintendent of Insurance of the Province of Alberta. Interest was in fact paid on the subordinated notes for a time without the consent of the Superintendent. Subsequent to the payments in cash, interest payments were waived. As noted elsewhere in this Report, while the interest was paid by FIC in cash, it was refunded through the transfer of Matrix shares to FIC in 1984 and 1985 [Transaction #7]. [14132; 17223]

The promissory notes were made by FIC following a series of negotiations with Alberta regulators during the spring and summer of 1984 leading to a letter agreement dated December 18, 1984 which provided as follows:

1. $11,300,000 would be injected by PGL into FIC by way of a promissory note sub ordinated on terms acceptable to the Superintendent of Insurance. This injection of capital was regarded only as a resolution of the problems arising by reason of the [Transaction #1];
2. If the injection was made, the Superintendent of Insurance would withdraw his previous demand that the transaction be reversed;
3. The notes were to provide that neither the principal nor interest would be paid without the prior written approval of the Superintendent of Insurance;
4. The Superintendent of Insurance agreed to forego any action based on the 1983 Financial Statements regarding the outstanding items in his letter of May 11, 1984 until such time as he had received and reviewed the 1984 Financial Statements of FIC and AIC. [Exhibit 280, Tab 4]

The agreement was made by FIC and AIC to avert the Superintendent from pursuing reversal of the transaction. The Alberta regulators were not aware of the transaction prior to its implementation and so of course did not approve it. [15544-5] The requirement for an injection of $11,300,000 was derived from the opinion of Bercov, who was retained by the Superintendent of Insurance to assess the harm done to FIC and AIC by this transaction. Bercov advised that the loss sustained by FIC and AIC by reason of this transaction was between $6,300,000 and $11,300,000. [Exhibit 280, Tab 6] As just mentioned, the $11,300,000 injection was by way of 2 loans, one in an amount of $6,300,000 and the other in an amount of $5,000,000. The reason underlying this breakdown is of interest.

Prior to March 23, 1984 the Department of Insurance Canada, in reviewing PS&T's operations, had observed that PS&T would be required to write down the value attributed to its interest in certain owned properties and mortgages by over $9,000,000, or else submit updated appraisal information on most of the portfolio. PS&T did neither, but on March 23, 1984 transferred its interests in the Properties and Mortgages to FIC and AIC. CDIC, upon review of the sale, was concerned that the Alberta regulators would require the sale to be reversed and therefore required that $6,300,000 be injected into PS&T. In response to this requirement, PGL made, in June and July, 1984, 2 loans to PS&T totalling $6,300,000. [Exhibit 363 at 6, 8, 39, 47]

The agreement between the Principal Group and the Superintendent of Insurance respecting the $11,300,000 loan to FIC was conditional on CDIC permitting PS&T to repay the $6,300,000 to PGL. CDIC agreed to this upon confirmation that the Superintendent of Insurance would not seek to reverse Transaction #1.

Both Donald Cormie and Marlin denied any link between the transactions. But on December 17, 1984, the day on which PGL advanced the $5,000,000 to FIC at prime plus 2½% per annum, FIC lent to PGL the sum of $3,500,000 and AIC lent to PGL the sum of $500,000, both loans bearing interest at prime plus 2 ½% per annum. Given that PGL was cash poor at this time — at December 31, 1984 its cash balance (unconsolidated) was zero [Exhibit 611, Appendix 4] — I find it hard to believe that the timing of these loans to PGL, on the same day as PGL injected money into FIC, was mere coincidence. Owing to this event, PGL commenced borrowing money from FIC and AIC, as authorized by a PGL director's resolution signed by the 4 directors and dated December 17, 1984. Donald Cormie and Marlin were aware of the fact that both events occurred on the same day, as was James Cormie, who signed the $5,000,000 cheque dated December 17, 1984. [Exhibit 611, Appendix 5; Exhibit 446; Exhibit 563 at 466, 469 and 471; Exhibit 451 at 35; Donald Cormie, 17251-2; 21141-3; 22052-60; Marlin, 13351-2]

I have calculated the annual cost to FIC and AIC, in terms of cash flow, of the acquisition of PS&T's interest in the Properties and Mortgages. I have assumed for the purpose of the calculation that the loans to PGL by FIC and AIC were unrelated to the advance of $5,000,000 by PGL and FIC. Even on this basis the annual cost to FIC and AIC of this transaction was substantial. According to the evidence of James Cormie and Donald Cormie, PGL's Investment Department in 1984 was earning approximately 20% per annum on funds invested by it. On the other hand, the cash income from the Mortgages and Properties was negligible. [14173-5] Had the $23,245,129 price paid by FIC and AIC for the Properties and Mortgages been invested by PGL's Investment Department on behalf of FIC and AIC, it should have earned approximately $4,649,000 per annum.

During the course of his testimony, I put to Donald Cormie that the cost of the transaction in terms of lost cash flow was approximately $6,000,000, leaving aside the fact that FIC did not receive and therefore could not invest the $11,300,000 until approximately 9 months after the transaction. Donald Cormie agreed with that, and also agreed that the $11,300,000 received in December, 1984 could have been invested at approximately 20%, returning $2,200,000 per annum. The total loss so calculated would have been approximately $3,800,000 annually for 1985 and the next number of years. [17257-9]

When asked whether a transaction which caused FIC losses of some $3,800,000 was good for FIC, Donald Cormie responded that FIC was able to take the Properties and Mortgages and enter into some quite favourable transactions; otherwise, FIC would have had to write the Properties and Mortgages down. [17257-9]

The annual cost to FIC is calculated as follows:

Paid to PS&T	$22,553,655
Less:	
Received from PGL	11,300,000
Net cash paid out	$11,253,655
x 20%	
Loss in cash flow	$ 2,250,731

The annual cost to AIC is calculated as follows:

Paid to PS&T	$ 691,474
Less:	
Received from PGL	—
Net cash paid out	$ 691,474
x 20%	
Loss in cash flow	$ 138,295

This analysis attributes no cost to interest on the subordinated notes. AIC gave no such notes in respect of this transaction, and accordingly this aspect can be ignored in its case. FIC borrowed $11,300,000 at prime plus 2½% per annum. Both Donald Cormie and James Cormie emphasized in their testimony that the interest had been "forgiven" and repaid (see Transactions #7 and #19 *infra*). Even accepting this assertion, the annual cost to FIC as computed above was $2,250,731.

I do not, however, accept their assertion. The subordinated note interest was paid in cash. At year end, PGL might "waive" the payments already received or it might not. Any such waiver of interest was discretionary on the part of PGL. It is not therefore properly considered. Moreover, the waived interest was repaid for the years ended 1984 and 1985 through the transfer to FIC of Matrix common shares, which were non-earning and of questionable value. They can therefore be ignored for the purposes of this analysis. In respect of the 1986 waiver, FIC received $1,200,000 cash in partial payment and as noted hereafter, I cannot find what asset FIC might have received in payment of the balance had the intervening failure not occurred. While it might be argued that any calculation of cost for 1986 ought to be adjusted for receipt of the $1,200,000, I note that only a portion of that could be attributed to interest costs (44% of the total amount waived was subordinated note interest [Exhibit 611 at 50]) and in any case, the waiver is, as I have said, discretionary.

Therefore, interest costs are properly attributable as losses on these notes. That cost would be between $1,200,000 and $1,400,000 per year depending on the prime rate. Considering the prime rates then in effect [Exhibit 421, and Exhibit 608 at 353-60], $1,300,000 per year (based on a prime rate of 9%) is a very conservative estimate of the loss.

Moreover because FIC did not receive the borrowed funds until December, 1984, 8½ months after the transaction, it incurred an additional loss calculated as follows:

$$(\$22{,}553{,}655 \times 20\%) \times \frac{8.5}{12} = \$3{,}195{,}101$$

On the foregoing analysis therefore, FIC lost $3,195,101 over 1984 and could be expected to lose in the range of $3,500,000 annually, commencing in 1985, depending on the prime rate. The loss was substantial.

My analysis assumes that all the funds could have been invested by the investment department, thereby yielding the 20% return. Other investment alternatives were available, such as collateral loans. However, having heard the evidence, I find the assumption is reasonable.

The issues that arise on these facts are first, whether the transaction is a "sale" or a "tender"; and secondly, whether it was a prudent transaction undertaken for *bona fide* business purposes. Both issues are relevant to my mandate as I am to report, *inter alia*, whether there is evidence tending to show that persons concerned with the business or affairs of FIC, AIC and their affiliates have acted fraudulently or dishonestly or that there has been oppressive, unfairly prejudicial or other conduct within the terms of s. 223(2)(b) of the *BCA*.

As to the first issue, s. 138 of the *Trust Companies Act*, R.S.A. 1980, c. T-9 provides as follows:

> 138. A company shall not
>
> (a) sell any mortgage, loan, securities, real estate or leasehold estate to any corporation affiliated with it other than an ancillary corporation of the company. . . .

In addition, FIC and AIC were not empowered to purchase real estate (except in those limited circumstances permitted by s. 36 of the *ICA* as to which, see Chapter X, *infra*).

Johnson testified that when he joined the Principal Group in late 1984 (after execution of the transaction), he heard the transaction described as a "tender". [6370] He testified that although as a member of the mortgage investment committee he dealt with approving the disposal of owned property, he never was aware of any agreement or policy among and between FIC, AIC and PS&T with respect to any disagreement that might arise as to how to treat a jointly held mortgage or jointly held owned property. [6398]

Johnson also testified with regard to the Mortgages and Properties that it had been expressed to him that it was considered beneficial to have the real estate owned by one company. As such it could be more easily dealt with in terms of development or enhancing the value for resale. It had been expressed to him that some of the Mortgages and Properties were of a sort that required work to enhance their value and make them more saleable. [7519-20]

The methodology used by the Principal Group to value its mortgages and owned property is described in another section of this Report. For present purposes, it is sufficient to note that in 1984 the valuation of underlying security for mortgages had been, and of owned property was coming to be, based on what the property would be worth 3 or 4 years later, with the benefit of some notion, perhaps ill-advised, of economic or real estate market recovery. In 1985, the "time horizon" came to be 7 years. Johnson testified [7377] that for internal purposes, the Principal Group used the same valuation techniques for the holdings of PS&T, FIC and AIC. According to Johnson, the examiners for CDIC, on the other hand, were much more stringent in their requirements for valuing real estate, and used what he described variously as "liquidation values" [7378] and "more of a current liquidation value rather than allowing for any economic recovery". Johnson agreed that the difference was between allowing for a 3 to 4 year economic recovery of the real estate market with a consequent favourable impact on the value of the mortgages and owned properties, as opposed to assessing values during the accounting period at market value. [6376]

Patrick testified [8564-77] that he received a memorandum from Green, the mortgage manager, to Donald Cormie dated March 28, 1984. The memorandum stated:

> Pursuant to our discussions whereby you have indicated your desire to have the Trust Company divest itself of its portion of its shared mortgages, we have prepared, for your review, a list of subject mortgages and same is enclosed herewith.
>
> All of the mortgages are in default. We expect most of them will become Owned Property in due course, with Brittania and James Hudson — Central, coming in within the next few days.
>
> By copy of this letter, we are asking our Legal Department to advise what the regulatory and legal requirements for a transaction of this nature would be. Upon receipt of their opinion we will pursue the matter further. [Exhibit 281, Tab 2]

Patrick had a discussion with Donald Cormie, James Cormie and Petracca about the transaction. The proposition given to Patrick upon which he was to provide an opinion, was that where one party to an arrangement perceives that certain action or lack thereof by another party will have adverse results regarding an asset in question, then such party is obliged by law to take steps to mitigate the adverse consequence by, for example, redeeming the other party's interest. It was to be a unilateral action by FIC and AIC which, according to the corporate position on the issue, would not amount to a sale under the *Trust Companies Act*.

Patrick transcribed his notes of the meeting into the form of a memorandum, which was dated April 13, 1984 and addressed to Petracca. [Exhibit 350 at 141] That memorandum set out the above so-called legal principle on which opinion was requested and provided a brief description of some facts as related to him. The memorandum expressed in writing the conclusion that since the action would be unilateral on the part of FIC, the earmarks at law of a sale would not be present and the transaction would not be a sale. Patrick's *viva voce* evidence, however, was that the transaction was, in fact, a sale. His evidence was that he prepared this memorandum and sent it to Petracca to determine whether he had correctly interpreted the corporate position and the matters on which an opinion was required of him on this issue. He advised Donald Cormie and Petracca that he could not give the opinion outlined in the memorandum. He testified that Donald Cormie insisted on having a favourable legal opinion. Patrick consulted P.M. Owen, Q.C., an Edmonton lawyer. Owen concurred with Patrick and this was communicated to Petracca. [8564-77; 8883-6]

On April 16, 1984, the directors of FIC and AIC, Marlin and Espenberg, ratified the transaction. [Exhibit 280, Tab 1] On April 17, 1984, Petracca instructed Owen to opine whether the transaction was a sale. Petracca provided to Owen, in her letter of instruction, Patrick's memorandum, describing it as a memorandum from "our in-house legal counsel, Lynn Patrick, with respect to the essence of the transaction and his thoughts related to the applicability of Section 138 of the *Trust Companies Act*." She asked for a legal opinion which would "hopefully, [concur] with our in-house interpretation of the same" which, she suggested, was that the transaction did not amount to a sale. [Exhibit 281, Tab 8]

Owen replied on April 25, 1984. His opinion recognized and accepted the existence of a corporate policy by which the interests of the participants (FIC, AIC and PS&T) in mortgages had been changed as amongst them from time to time as circumstances warranted. Notwithstanding that, his opinion was that the transaction constituted a sale, which would be prohibited by s. 138 of the *Trust Companies Act*. He also gave a preliminary opinion as to whether the transaction might be void and reversible. [Exhibit 280, Tab 8]

By letter dated May 7, 1984 [Exhibit 280, Tab 8], C.R. Henning, of the law firm Parlee, Irving, Henning, Mustard & Rodney, rendered an opinion that the exercise by FIC of its rights under a certain policy should not be characterized as a purchase and sale of security interests. The policy, attached to the letter, stated:

> In the event that Principal Savings & Trust Company ("Principal") takes any action or refuses to take any action on security granted to it by a borrower which, in the opinion of First Investors Corporation Ltd. ("FIC"), and/or Associated Investors of Canada Ltd. ("AIC"), may adversely affect the security granted by such borrower to FIC or AIC, FIC or AIC shall be entitled to pay out the balance owing by such borrower to Principal. In the event that FIC or AIC pays out the balance owing by such borrower to Principal, FIC or AIC shall be subrogated to all the rights of Principal under and by virtue of the security granted by such borrower to Principal.

The policy is undated and executed by Marlin and Espenberg on behalf of FIC and AIC. As noted below, it was not drafted until sometime in May, 1984.

By letter dated February 24, 1984 [Exhibit 364 at 6], the Department of Insurance Canada (which, on behalf of CDIC, was responsible for inspecting PS&T) made certain demands of PS&T. The letter, while addressed to the Director of Trust Companies, Government of Alberta, came to John Cormie's attention shortly after its dispatch. [9213] The letter criticized the state of affairs of PS&T and, in particular, cited several deficiencies in the mortgage portfolio. The Department of Insurance made a number of recommendations and stated that in order to forestall CDIC from making a formal report to PS&T pursuant to s. 31 (formerly s. 25) of the *Canada Deposit Insurance Corporation Act*, R.S.C. 1985, c. C-3, PS&T should:

(i) convert $6,000,000 of subordinated shareholders loans into permanent capital;

(ii) obtain $2,000,000 additional capital;

(iii) achieve better matching; and

(iv) establish $9,500,000 in specific additional reserves on mortgages and real property or alternatively, submit updated appraisal information on all properties having a book value in excess of a certain amount.

The letter stated that if PS&T did not respond to the concerns within a reasonable time, it was likely that CDIC would issue a formal report summarizing PS&T's unsound business or financial practices. The letter noted that once such a report was made, CDIC would be in a position to give notice of cancellation of PS&T's policy of deposit insurance. John Cormie testified that he regarded the letter as a threat to cancel the deposit insurance coverage. [9222] He testified that this letter was a "motivating force" in carrying out Transaction #1. [9226]

John Cormie also testified that the impetus for the transaction came from FIC, which perceived a contingent liability based on the valuations that CDIC had put on mortgages in which FIC held an interest. [9222] Moreover, PGL, he said, recognized that there would be a capital injection required to cover the loss of value on the Mortgages and Properties. The question was where it was best to inject the capital; since FIC had the largest exposure on the Mortgages and Properties, it would seem reasonable to put the Mortgages and Properties into FIC and to inject the capital there. If the capital were to be injected, he said, PGL wished all the Mortgages and Properties to be in one company. He testified that from PS&T's point of view, while the capital could have been injected to support write offs against the Mortgages and Properties, there would still be a problem of different jurisdictions over these assets. [9224-9] He said FIC and AIC felt that their values were prejudiced by the CDIC values and that "they were quite concerned over the effect that would have on their balance sheet". [9228]

John Cormie wrote to Pointe (the Director of Trust Companies for the Province of Alberta) on March 30, 1984 [Exhibit 364 at 15] and advised, *inter alia*, that the board of directors of PS&T generally concurred that the long-term strategy required to successfully market or develop a real estate portfolio was incompatible with a demand deposit-taking institution. As a consequence, the joint mortgage partners had paid out the large joint mortgages and real estate holdings of PS&T, effective March 23, 1984. The letter did not address all of the concerns of the Department of Insurance Canada. CDIC then threatened to issue a formal report which would enable it to cancel the deposit insurance coverage unless PS&T converted $6,000,000 in subordinated notes to capital, improved its matching, and changed its policy on capitalizing interest on loans. [Exhibit 363 at 28]

Concerning the nature of Transaction #1, John Cormie testified: [9270]

> Q How was it a tender transaction or in what sense was that term used?
>
> A I'm not sure. My sense of it was is that it was the right of a joint mortgage partner to acquire a joint interest. That was my sense of what that phrase meant.
>
> Q It certainly wasn't preparing a set of specifications and putting them out for tender, was it?
>
> A No, I didn't —
>
> Q Okay. Did it involve the consensus of the trust company and the two investment contract companies ultimately?
>
> A Did it involve —
>
> Q The consensus, the agreement?
>
> A Yes.

Subsequently he stated: [9272]

> Q . . . . Now, you're the president of the trust company at the time.
>
> Were you of the view that PS&T had a choice as to whether or not to sell or not to sell these mortgages?
>
> A I was under the impression that I had that right to reject or accept, but I must admit I'm not a lawyer and this became a legal issue at this time.

Then at 9275:

> Q Well, PS&T consented to the disposition, did they not?
>
> A Yes.
>
> Q And they did that through you or through a directors' meeting?
>
> A We would have had a directors' meeting approving it, yes, we would have.

Petracca testified that she understood Patrick's memorandum to be his opinion that the transaction was not a sale, and that she concluded that FIC and AIC were obliged to accept the tender. Petracca testified that after she received Owen's opinion, she still believed that the transaction was a tender. She testified that the policy upon which Henning opined was reduced to writing probably in the first part of May, 1984. She testified that it was definitely reduced to writing after the transaction and not before. She was told that this had been the policy of the Group for the previous 20 or 30 years. She could not find whether or not there was a written policy available, thus she dictated the policy. [10057-86; 11010-19] She testified that she could not recall who told her that such a policy existed; when she was told; where she was told; or in relation to what property a similar transaction had occurred, involving what companies, or for what consideration. [11240] She also testified that she was not sure why she would have asked for a second legal opinion, and agreed that the policy had probably not been reduced to writing at the time Owen had been instructed although he had been told that there had been a verbal policy in existence for many years. [10080]

As to the purpose of the transaction, Petracca testified [10065-70; 10073-4; 10080-1] that her information was that CDIC was pressuring PS&T for considerable reserves on its portfolio. She also understood, from discussions with a "senior CDIC auditor", that CDIC was using a "generalized across-the-board" method of valuation of real estate. She understood that the Alberta regulators had agreed that it would be in the best interest of all concerned to work out the mortgage and owned property portfolios over time and they were therefore more inclined to consider a longer term valuation as opposed to an immediate valuation. She described CDIC's method of valuation as a "liquidation value" [10067-8] or a "current value". [10080] She testified that the general feeling was that FIC and AIC might be forced to apply the values imposed by CDIC to their portfolios unless PS&T no longer held an interest in the Properties and Mortgages.

Petracca agreed that her involvement in obtaining legal opinions and dealing with the regulators was in order to make certain that it was the Alberta investment contract company regulators who dealt with the portfolio, rather than the trust company regulators. [10080-1]

Marlin testified [11910-17] that CDIC were "giving us a tough time on the valuation of certain properties". In his view, this created a serious problem for FIC and AIC. The valuation techniques used with respect to real estate in those companies, which did not hold demand deposits and had 7 years under the *ICA* to liquidate the property, were, he said, different. There was concern about the portfolio of FIC and AIC being influenced by the value being placed on the Mortgages and Properties in PS&T and it was decided that it would be prudent to remove that threat. He stated:

> In discussing it at the directors' level, at the Principal Group directors' level, it was decided that the logical solution was that First and Associated should tender for Principal Savings & Trust's portion of those mortgages, which was done. [11913]

Marlin testified that his participation in the discussion was not only as a director of PGL, but also in his capacity as president and a director of FIC, and that similarly John Cormie, also a PGL director, participated as president of PS&T. [11916] He stated that when the tender was done, the PGL directors knew there would have to be a compensating capital injection to FIC and AIC "if deemed necessary". [11916-7] He later testified that the directors of PGL knew there would have to be a compensating capital injection. [12960]

Marlin was aware of the letter of February 24, 1984 from CDIC, which he understood made demands for more capital based on CDIC's approach to valuation. This was, in his mind, of concern to FIC and AIC. He testified that he was not aware of the specific threat respecting issuance of a formal report under s. 31 of the *Canada Deposit Insurance Corporation Act* at the time the transaction was conceived and executed. [37222-4]

Marlin's evidence was that CDIC valued real estate at current market value, something not appropriate for FIC and AIC with their different "time horizon" upon which to realize the value of real estate. Thus, the benefit to FIC and AIC, he said, was elimination of the threat of property being written down to CDIC valuations. [11913-17] Against that, he said, there was weighed the $23,000,000 cash payment. He testified:

> Q You must have weighed that, Mr. Marlin, against a $23 million cash payment?
>
> A Yes, we weighed that — the $23 million cash payment bought the mortgage and real estate at book value. We realized that that portfolio had been reserved down in Principal Savings & Trust by, I believe, something like $4½ million.
>
> We chose to, if you like, tender at the book value and provide a reserve, *if deemed necessary*, in the investment contract companies as opposed to transferring or accepting the valuation, the CDIC valuation. The thinking behind that was that if we moved them at book, they would come onto First and Associated's books at that value. If we reserved against them and subsequently could increase the value of that real estate, we could write it up again; whereas if we had transferred it at the written down value, we would be faced with that same problem of not being able to bring — to increase the value as we enhanced the value of the property. (Emphasis added.) [11917]

Marlin testified that the valuation problems were more easily dealt with in FIC and AIC:

> Q Obviously, you made a calculation in your own mind that dealing with the provincial regulators was the road of least resistance, that's the way we should go on it?
>
> A I'm not sure we thought of it specifically in those terms, but certainly it was more easily dealt with in the investment contract companies than in the trust company. [13328]

Marlin testified that it was his understanding that where FIC and AIC had joint mortgages, it was, owing to previous practice, normal procedure that they would tender for the mortgage or the property, as the case may be, at book value. He said that Donald Cormie explained this to him, and his understanding existed before this transaction was undertaken. It was his belief that it had been done before, but he could not recall any specific incidents. [11921; 11923; 12958-60; 13513-4]

James Cormie testified as to the existence of a concept that allowed a joint mortgage holder, if it had a disagreement with another, to tender out the other company's pro rata share of the investment, thereby taking complete control and being able to deal with it as that company wished. By "tender out", he meant to pay out at book value. Further, he testified, that for tendering, one had to pay book value. He testified that he believed this had been done before in the history of the companies. He had heard about the concept long before this transaction was contemplated. However, he had never seen it done. He further testified that the other party would have to consent to the transaction, and that it involved an agreement between PS&T and FIC and AIC. Subsequently, he testified that PS&T would not necessarily have to agree. [14112-31]

James Cormie's position was that the transaction benefited FIC and AIC. They already owned an 80% interest in the covenants secured by the Mortgages, and they would receive 100%, plus a commitment from PGL to cover them for "valuation discrepancies". The reference to owning the covenants means that certain of the Mortgages and Properties were, owing to cross-collateralization arrangements, security for other loans held solely by FIC or AIC. [14120-6; 14177; 14883; 14975] The benefit to the transaction was complete control [14131], allowing FIC and AIC to recover value without PS&T's tendency to sell and "take cash and run". [14114] He gave evidence that the different regulatory environments were forcing the management of FIC and AIC into disagreement with the management of PS&T over valuation and future dealing with the Mortgages and Properties. [14112-4]

James Cormie testified that PGL committed to cover any inequity that might be caused by the transfer of the Properties and Mortgages. Further, he testified that a capital injection would be required either in PS&T or FIC and AIC, it being simply a matter of where to inject the capital. From PGL's perspective, it was preferable to have the Mortgages and Properties within one regulatory and one audit environment. He testified that choosing the regulator with which to deal was a factor, particularly since CDIC valuation methods were known to be tougher (i.e., would result in lower values) while FIC and AIC were permitted to value their portfolio over a longer time horizon. He stated that CDIC insisted on "forced sale" valuation, in contrast to the Alberta regulators' attitude, allowing a longer-term valuation. [14139-40; 14973]

James Cormie was adamant that in PGL's opinion the PS&T portfolio was probably not worth $23,000,000 and that the board of directors of PGL was prepared to inject capital in whichever company ultimately held the portfolio, to cover deficiencies in value. [14883] This is in contrast to Marlin's position; he wrote, on behalf of FIC and AIC, in an acknowledgment of agreement to the proposal outlined in the letter dated December 18, 1984 [Exhibit 280, Tab 4], that in the opinion of PGL, the market value of the property purchased by FIC and AIC was not less than the $23,000,000 book value. In addition, correspondence authored by Petracca [Exhibit 372 at 204] stated that the tender amount of $23,200,000 represented the book and fair market value. In a letter dated July 24, 1984 [Exhibit 369 at 407], addressed to Bercov, Petracca wrote that management did not anticipate any losses in total on the tendered portfolio. The letter was written on PGL stationery and signed by Petracca as Vice President of Corporate Development.

James Cormie disagreed that the PGL board engineered and implemented this transaction for the purposes of saving PS&T. [14892]

Donald Cormie testified that the above-mentioned letter of February 24, 1984 from the Department of Insurance Canada was brought to his attention as chairman of the board of PS&T. [17178] He agreed that one of the reasons for executing Transaction #1 was that there would be a significant write down of the Properties and Mortgages in PS&T if they remained there. [17183, 17935] He testified that in looking at the Mortgages and Properties in detail during the course of the audit, it was discovered that FIC had the large bulk of the covenants (that is, owing to cross-collateralization of certain loans, these properties were security for other loans due solely to FIC).

Donald Cormie testified that a meeting was held where Marlin represented FIC, John Cormie represented PS&T and Donald Cormie represented PGL. The purpose of the meeting, according to Donald Cormie's testimony, was to decide what the impact would be on FIC if PS&T were to write down its portion of the Mortgages and Properties to "liquidating value". It was decided that it would be better to have FIC hold the entire interest. That avoided the possibility of PS&T selling its interest to a third party and thereby inhibiting FIC from dealing with the Mortgages and Properties. He acknowledged in cross-examination that PS&T did not even solicit any third parties to purchase any of the interests. He testified that it was intended that PGL would make up the valuation difference. Since it was obvious that PGL would have to capitalize PS&T in any event, he said, the decision was made to proceed with the tender. Donald Cormie's evidence was that the federal valuation standards were tougher than those applied to FIC and AIC by the Alberta regulators. He testified that the transaction avoided a conflict in objectives between FIC and AIC on the one hand, and PS&T on the other. [17176-90]

As to the second justification, that of conflicting objectives, Donald Cormie testified:

> Q Now, I think some people have difficulty accepting that as a reason when we know that the parent could control the activities of the subs, ultimately PGL or you could direct the disposition. That is number one.
>
> Number two is that functionally, the Mortgage Department of PGL managed mortgages under the agreements, whether they are PS&T, shared or not, right?
>
> A Yes, but in actual fact, we had — we were developing the trust company and they were — their own people, like John Cormie and George Aboussafy were working on the trust company's problems, or how to get its real estate out independently of the Mortgage Department.

Q Let's go at it another way. This deal, as conceived, the tender transaction that PS&T would dispose of $23 million of its interest in mortgages at book value to the investment contract companies, it could not have proceeded without your agreement?

A No, no. Principal Group was agreeing to put in —

Q No, Don Cormie. It couldn't have proceeded without Don Cormie's agreement?

A Oh, I would doubt they would have, yes, that is correct. I would think that if it affected two companies, they couldn't proceed without my agreement. [17193]

Donald Cormie testified that the benefits of the transaction to FIC and AIC were first, with all the property in FIC, a higher valuation could be sustained for whatever reason; and secondly, by having control of the properties, the investment contract companies were able to proceed with trans actions which would enhance the value, such as the Carma transaction (Transaction #3, *infra*). That was possible, he said, because FIC and AIC had no outside directors. PS&T did, and those directors who "weren't about to say you do whatever I want", might not consider the interests of the Group, "anything else other than that one company, at that time", nor be concerned about "transactions that might be for the future". [17217-20]

Under examination by his own counsel, Donald Cormie reiterated the reasons for the transfer. First, PS&T was in the position where it had to seriously consider doing something with its interest in these holdings. It was being faced with determining a "liquidating type value" on its partial interest. Next, FIC having only a 50 or 60% interest, was not able to freely deal with the property under its parameters, and was being inhibited by the *Trust Companies Act* and the trust company parameters as to what it could do and the type of transactions that could be entered into. Finally, the benefit was that if FIC and AIC did not have control of the properties, they would have great difficulty doing anything with them or holding their values or transacting on them. [18826-7]

Further, in response to my questions, Donald Cormie testified as follows:

THE INSPECTOR:

I assume they would like to have sold them at book value to Principal Savings & Trust, wouldn't they have?

A Yes, I assume that they might have liked to have sold them at book value. Well, I am not so sure because I guess the question in there is that what value is Principal Savings & Trust going to put on them and then —

THE INSPECTOR:

What does that mean?

A Well, I guess the two companies are working in different environments. They are worth more to First than they are to the trust company, let's put it that way, because they have different time horizons and powers to do things. [18827-8]

Donald Cormie testified that he was aware that PS&T would be unable to sell the properties to FIC and AIC and so there would have to be a tender. His evidence was that Ralph Forster (one of the founders of FIC) had determined that the tendering arrangement was a legal and proper way for the joint mortgage holders to unwind their positions without violating the *Trust Companies Act*. The other party would be obliged to accept the tender of cash and quit claim the property. The policy or procedure had been established 15 or 20 years earlier. Donald Cormie, like the other witnesses, was unable to recall any instance where this tendering process had ever been used before. He testified that he thought the policy had been reduced to writing. He suggested to Petracca that she go and find it. She could not and therefore, Donald Cormie suggested she get new legal opinions. [17190-200]

Donald Cormie agreed that he reviewed and was aware of the Owen opinion when it was received, and on or about April 25, 1984 he knew that outside counsel had indicated that the transaction was not a tender, but rather a sale. Donald Cormie's response to that suggestion was:

> Yes. I wasn't sure at this time whether he had the transaction exact, but I assume he did. [17203]

He went on to explain that he took no steps to unwind the transaction. As the transaction had occurred, it was now a matter to be taken up with the regulators; his concern was focused on remedies that might be available to the regulators to unwind the transaction. [17200-5]

Donald Cormie testified that the Owen opinion prompted a formalization of the policy. Donald Cormie agreed that he suggested that a policy, as attached to the May 7, 1984 legal opinion and quoted above, ought to have been reduced to writing, and that he was in favour of obtaining another legal opinion because he was not sure that Owen had all of the facts. [17205-8]

I note that on the face of his opinion, Owen had all the facts.

Donald Cormie testified that he reviewed the written policy before it was signed [17207], and further:

> Q Does this accurately reflect the policy that you say existed at the time the first joint mortgage was granted?
>
> A Yes, it seems to reflect it. I would have thought that it should have provided for the quit claim specifically in it, but, however, it was —
>
> Q I thought you reviewed it.
>
> A Yes, I did.
>
> Q You didn't change it?
>
> A No, I didn't change it.
>
> Q You could have changed it?
>
> A Yes, or I could have suggested changes, certainly.
>
> Q Right, and you didn't?
>
> A No. . . . [17208]

Donald Cormie was then asked whether the action or inaction of PS&T was adversely affecting the investment of FIC and AIC in each of the Mortgages and Properties, as the policy on its face requires as a prerequisite to FIC or AIC being entitled to pay out the balance owing to PS&T. His reply was that he did not know and in any case, this policy was drafted after the event and the transaction was not done pursuant to this policy, but rather pursuant to "what was perceived to be the long-standing policy". The "long-standing policy", he said, differed from what was written down in that under the "long-standing policy", a party could tender for any reason, and as long as book value was tendered, the other party was obliged to quit claim. While it was intended in reducing the policy in writing to reflect the "long-standing policy", Donald Cormie testified that he did not consider it extensively at the time. He testified that while he reviewed it, he did not write it and he did not change it. [17209-13]

This is an example of Donald Cormie "elaborating" on his own previous testimony once he understood the point in issue. Under cross-examination by Mr. White [22026], Donald Cormie refused to acknowledge even that the transaction was pursuant to the long-standing practice.

Donald Cormie testified that when considering undertaking the transaction, he knew that the book value of the Mortgages and Properties was more than the value the auditors had attributed to those interests; that the Mortgages were substantially in arrears; and that it was specifically discussed among the participants that there would be a compensating amount paid by PGL, whether to PS&T or to AIC and FIC. Initially, he said, the audit on PS&T suggested that the sum would be $4,500,000. The participants assumed that the required capital injection would be around $5,000,000. He stated that it was then decided that the capital contribution could be based on CDIC's assessment of the values because that view was usually the lowest and unlikely to be disputed by FIC, AIC or the regulators. [17213-5; 22039]

If indeed PGL intended to voluntarily contribute capital to make good the loss, the question that is not satisfactorily answered is why the contribution bore interest at prime plus 2½% per annum. Donald Cormie said originally the intention was to "just" contribute capital; the interest rate "came later". [17215-8] Subsequently he testified that the practice was to put up capital by way of subordinated note, giving PGL the opportunity to recover the money later and to be paid interest in the meantime. [17253-56] He also testified that interest was charged on the note because it bore interest, and "we felt that it did give the flexibility of waiving the interest, if it was required". [18833-4]

Donald Cormie also testified that the capital was inserted by way of subordinated note because there was a possibility that the purpose for which the capital was inserted would be exhausted fairly soon, allowing recovery of the cash. That, he said, was the case here "because we assume the market was coming back and we believed in Alberta and thought that the Alberta real estate would come back." As noted below, there is evidence that the witness did not believe that Alberta real estate would recover. Confronted with that evidence, Donald Cormie said real estate would recover from its drop, but not to where it originally stood. The expectation, he said, was a 40% drop and 20% recovery. There would, therefore, be a substantial return to FIC, he said, by holding the property. [18828-33]

In contrast to the benefits said to accrue to FIC and AIC by virtue of Transaction #1, Donald Cormie's evidence was also that in October, 1983, the Principal Group decided to completely retire from the mortgage placement business. A memorandum written in October, 1983 by Donald Cormie stated:

> It is our view that the real estate market will be basically flat and, as a result, there will be considerable risk in placing mortgages without a rising market to cure all our mistakes.
>
> In addition, we feel that in five to eight years, the price of real estate will start to decline and money will become tight, which would cause a considerable number of defaults on mortgages. Consequently, our strategy would call for us to be completely out of the mort gage business in approximately five to eight years. . . . [Exhibit 442 at 154]

Donald Cormie elaborated that he expected real estate to be "very flat" and go down and up at the "beginning and ending". The ending is 1991. But FIC in the meantime, he said, was acquiring the real estate at 25% off its book value (owing to PGL's alleged intention to compensate FIC for any difference in value) and would therefore have the opportunity to recover it. [17220-3]

There is other evidence of Donald Cormie's view of real estate.

On May 7, 1984, Donald Cormie spoke to Pennock of Touche Ross & Co., then auditor of Principal Group, to register his displeasure with the contingency note to the 1983 audited financial statements of FIC and AIC (notes of the conversation taken by Pennock are in Exhibit 526 at 58). In testifying to that conversation, Donald Cormie said:

> A Well, the problem all resolved [sic] around the valuation of real estate and whether or not real estate was going to recover or was not going to recover and the valuation. It was an unbelievably uncertain environment because we were getting appraisals that would vary up to 100 percent different between two appraisals in the same period.
>
> So the concern was that would the real estate — would there be further write-downs, would the market keep dropping, would it be flat, would it rise, so it all revolved around that. It was almost like a guessing game at the time. [19096]

Donald Cormie testified that he felt that the market had dropped and he was expecting a recovery of part of the drop. When confronted with his earlier memorandum, Donald Cormie was quick to point out that the memorandum stated that the market would be "basically" flat; that the market would come back up to a certain level and then the next problem area would occur in about 1990. Otherwise, he testified, he would have said "flat" in his memorandum. [19097] In search for a new ad jective, he finally stated:

> It is going to be moving up and down and it will end up essentially flat. [19097]

Donald Cormie later testified [21423] that the real estate decline became apparent by the end of 1983 and that the decline was temporary (anywhere from 3 to 7 years). Again confronted with his memorandum of October, 1983, Donald Cormie gave the following evidence: [21424-5]

> Q . . . Now, I put to you, sir, that as evidence, the statement you made moments ago that you believed that there would be a decline from three to seven years starting in 1983, that not even you believed that, Mr. Cormie.
>
> A Yes, that is correct. I mean, we did think there was going to be a recovery.
>
> Q Mr. Cormie, you said a few minutes ago that you believed there would be a decline . . . it would be a decline that would persist for from three to seven years from 1983?
>
> A And a recovery.
>
> Q And, sir, in this memorandum dated 1983, you say it is going to be flat and that in five to eight years it will decline.
>
> A I said basically flat. A down and an up.

In a speech given by Donald Cormie (on the subject of his theories of cyclical patterns in economic events) in November, 1983 which was video taped and adduced as evidence during his testimony [Exhibit 496, and transcribed at 22125-65], Donald Cormie said this:

> Now, the logical question would be well, where do we sit currently on one of those patterns and what should we be doing and what are the opportunities and what are the dangers.
>
> Well, there is one — there is certain things occur during those periods. Usually when you get that tripling of prices and commodities, real estate goes with it. When you get that one-third break in commodity prices, that is the signal that inflation is all over. That is the signal that real estate has hit its 55-year peak, price peak, which occurred about two and a half years ago, two years ago.
>
> Then the other thing that happens is when the commodity prices peak, the stock market bottoms. And so we — that is the signal that you are on the beginning of a big stock market rise.
>
> Now, we have a pattern in there . . . .
>
> Now we are in the period where it breaks out, the stock market breaks out, and I believe if you looked at the Dow Jones and adjust it for inflation, it is probably down around about 300. So you are going to find that inflationary lag is going to be all caught up in the next few years. And that means that you are going to see the Dow Jones go over 2500 or 3000 within five to eight years.
>
> In fact, you are going to see the biggest stock market boom in history. It started a year ago.
>
> *The other aspect of that pattern is generally when commodity prices drop, real estate will stay flat for about eight to ten years. Then it breaks and swings into a long 20-year downslide.*
>
> *So I think you can see why our philosophy is basically to be out of the mortgage or real estate market. It is not that there is still five to eight years of a good market there, but you don't have those rising real estate prices to cure all your mistakes, which we have had for a long time, and so has everybody else.* (Emphasis added.)

Donald Cormie was also of the view that, as of 1983, one had seen the highest real estate prices one was going to see for 30 years. [22342; Exhibit 502]

Based on the above evidence, I do not accept the assertion that FIC would benefit from Transaction #1 owing to a recovery in the real estate market.

Donald Cormie also testified under cross-examination that the decision makers were considering disposing of the properties to third parties, not just FIC and AIC. He could not name any such parties. He stated that PS&T did not look for any third parties because he was concerned that such a sale would prejudice FIC and AIC and therefore the other route (i.e. the transfer to FIC and AIC) should be first explored. No steps were taken to have PS&T and FIC and AIC together dispose of the non-performing mortgages to some third party because nothing was "moving at that time in the Edmonton area". [22016-25] I do not therefore accept Donald Cormie's earlier evidence that there was any realistic possibility that PS&T might sell its interests to some third party and thereby inhibit FIC. He also testified [22025-7] that he was involved in the decision to have FIC and AIC tender on the Mortgages and Properties.

Donald Cormie also denied during cross-examination that all the Mortgages were in default at the time of the transfer. While that is what Green said in his March 28, 1984 memorandum addressed to Donald Cormie [Exhibit 280, Tab 2, quoted *supra*], and while Donald Cormie agreed that Green was reliable, accurate and diligent [22016], he doubted that fact. He did so on the basis of no facts, he said, but did not recollect those mortgages on the audit indicating that they were all in default. [22029-30] According to Exhibit 280, FIC working papers indicate that each of the Mortgages was in arrears. I cannot accept Donald Cormie's explanation nor his evidence on this point.

Finally, Donald Cormie disagreed that this transaction was done to save PS&T. [21136-46; 22059]

It is apparent that a significant purpose in entering this transaction was to remove the Mortgages and Properties from the jurisdiction of the Department of Insurance Canada and ultimately CDIC. All of the witnesses acknowledged that CDIC was prepared to take a hard line on the valuation of mortgages and real estate in Alberta. That position might consequently affect the values at which FIC and AIC (and ultimately PGL on a consolidated basis) carried the Properties and Mortgages on their books.

Some witnesses asserted that as long as the Mortgages and Properties were jointly held, there was the possibility of difference of opinion among the companies as to what should be done with them. There is no credible evidence that FIC and AIC on the one hand, and PS&T on the other, ever had a dispute over the treatment of any particular Property or Mortgage. Nor did the transaction eliminate all the joint holdings. In fact, after this transaction was completed, they continued to jointly participate in various real estate ventures (see also Transaction #5, *infra*). Moreover, no witness was able to point to any instance where the "tender" process had been previously employed.

It is notable that the Alberta regulators had historically been prepared to accept "capital injections" by way of subordinated promissory note. On the other hand, CDIC was demanding prior to this transaction that such notes in PS&T be converted to equity capital.

It is clear that if PS&T's interest in the Properties and Mortgages was transferred to FIC and AIC, any risk of a demand on PGL by any regulator to insert capital to cover the optimistic valuations would be minimized. While the witnesses who were directors of PGL asserted that from the start PGL was prepared to cover any inequity arising from the transaction, the documentary evidence shows continuing argument that the book value approximated market value. As noted, the witnesses acknowledged that Alberta regulators were less stringent in the valuation area. The activities of management in obtaining legal opinions was patently, as admitted by one witness, designed to ensure that the Mortgages and Properties remained in FIC and AIC. There is no evidence that any PGL official ever disclosed to the regulators the alleged commitment by PGL to cover the lack of value and in fact, the June 19, 1984 letter (co-authored by Donald Cormie and Marlin) to Saleh threatened that perhaps no further capital would be forthcoming. Finally, no "capital" was inserted until December, 1984. When it was, not only did PGL charge interest for it, but also it did not compensate FIC for its loss of use of the cash during the interim period. Had it not been for the actions of Saleh, Darwish, and the Audit Section, (described in Chapter X of this Report), it is probable that FIC would not have received any capital as compensation for acquiring the PS&T interest in the Properties and Mortgages at a price greatly in excess of their real value. I cannot accept the witnesses' evidence that PGL intended of its own volition to contribute capital to FIC and AIC to "compensate" them for the transaction and I note that Marlin's evidence was that PGL would contribute the capital "if deemed necessary".

I have set out the evidence of Patrick's memorandum and his *viva voce* evidence to opposite effect of the memorandum. I have considered whether the parties may have been operating under a misapprehension as to the legality of the transaction when they agreed to it. On the balance of probabilities I find Donald Cormie and Christa Petracca were aware that the internal legal counsel was of opinion that the transaction was a sale. Then Owen's opinion was received. Yet even then nobody in management unwound the transaction. Rather, after its receipt, and obviously at the direction or at least with the concurrence of Donald Cormie, Petracca put to paper the "tender policy" and finally received a favourable legal opinion.

However, the transaction did not fall even within that policy, in any event. First, there is no evidence that PS&T took or refused to take any action on any security. Indeed, PS&T's President, John Cormie, thought his consent to the transaction was required. Its Chairman, Donald Cormie, admitted that the transaction likely would not have taken place without his approval. The evidence of the Vice President of Investments of PGL, James Cormie, was at various times that PS&T would have to consent and that it would not have to consent. Secondly, there is no evidence that FIC or AIC ever held an opinion that any action or refusal of action adversely affected the security (as opposed to its recorded value) and PS&T was not proposing to do anything except make some adjustments to its books if forced to do so by CDIC.

This is evidence tending to show with respect to this transaction that Donald Cormie and Marlin gave no proper consideration to the interests of FIC and AIC. All of the Mortgages were in default. The Properties were all acquired as the result of foreclosure. FIC and AIC were not real estate development corporations. Their only legal option, having acquired the Properties, was to dispose of them within the holding period allowed by the *ICA*. Even if Donald Cormie's evidence that the real estate market would recover within three to five years is accepted (and it is not by me), the excessive price paid by FIC and AIC for those assets would have been recovered, at best, when the Properties (and Mortgages, once foreclosed) were sold some years later. However, the evidence tends to show that Donald Cormie either did not believe that the real estate market would recover or at best, was of the opinion that when and to what extent the market would recover was a matter of speculation. Donald Cormie thus, the evidence tends to show, caused FIC and AIC to compound their own immediate problems without any honest belief that they would ever recover the cash paid for the assets. Marlin did nothing to stop it and, like Donald Cormie, the evidence tends to show, he considered the interests of PS&T and PGL to be paramount. In the interim, as discussed above, FIC and AIC suffered a severe cash loss and cost in lost earning power at a time when they could ill afford it. Even after a legal opinion was received that stated that the transaction was illegal, neither Donald Cormie nor Marlin took any steps to extricate FIC and AIC from the transaction and indeed, Donald Cormie appears to have acted without regard to the legality of the transaction at all since he gave evidence that once the Owen opinion was received, the question became whether the transaction was reversible. Since PGL controlled both FIC and PS&T, it was reversible at the will of PGL.

The evidence tends to show that:

(i) Transaction #1 was illegal, being a sale and therefore being in violation of s. 138 of the *Trust Companies Act*;

(ii) The reasons for entering into this transaction were:

  (a) to avoid insistence by the federal regulators that PS&T carry the assets on its books at their present-realizable value as the effect of the real estate collapse became more and more manifest;

  (b) to avoid the necessity of PGL having to capitalize PS&T as required by the federal regulators, by moving the Mortgages and Properties to a less stringent regulatory regime;

  (c) to minimize the risk of PGL having to capitalize any of the 3 subsidiaries, and to inflate its own book value on a consolidated basis, by moving the Mortgages and Properties to a less stringent regulatory regime, and then refusing wherever possible to write-down mortgages and owned properties held by FIC and AIC;

  (d) to save PS&T by removing non-earning, illiquid assets from its portfolio, again at the expense of FIC and AIC;

(iii) Donald Cormie and Marlin decided to proceed with this transaction on the part of FIC and AIC. Donald Cormie and John Cormie decided to proceed with this transaction on behalf of PS&T. Petracca played no part in the decision to proceed with this transaction but participated in attempting to validate it through obtaining favourable legal opinions. James Cormie was aware of the transaction but does not appear to have been a part of the decision making process;

(iv) Donald Cormie's and Marlin's activity in respect of this transaction is evidence tending to show dishonest and fraudulent conduct. The transaction is also evidence tending to show activity on the part of Donald Cormie and Marlin which unfairly disregarded and unfairly prejudiced the interests of the investment contract holders in most particularly FIC, and AIC.

TRANSACTION #19

Effective December 31, 1986, FIC acquired PS&T's interest in 5 mortgages and 32 owned properties (as always, properties acquired through foreclosure proceedings, and throughout the within discussion of Transaction #19, the mortgages and owned properties are collectively referred to as the "Properties"). FIC purchased the Properties from PS&T for $9,220,322 in cash. Of the 37 assets sold, 9 were jointly-held prior to the sale by PS&T and FIC. Examination of the Schedules to the Agreement of Purchase and Sale discloses that about $4,540,000 of the purchase price related to jointly held interests. [Exhibit 292]

By letter dated February 24, 1987, Marlin on behalf of FIC stated to John Cormie on behalf of PS&T:

> In the intervening years, we found that the ability to deal with the properties to maximize the return of the owners is prevented by the difference between our companies arising from the time horizons for the respective types of businesses. We recognize that your company is in the deposit business and is looking for liquidating value of investments, whereas our company is in the insurance-type business with long-term reserve requirements, and a regulatory development period of seven years or longer if the property is in the basket clause.
>
> We are running into cases where it is urgent that your company put up its share of the funds for the various developments so that we can maximize the income from the property. The reluctance of your company to do so is causing losses for all parties. We do, however, understand that you are always looking at liquidating values, which is entirely different

> from the values attributable to our own companies, since we invest for the long term as required by the statute governing our company. [Exhibit 292, Tab 1]

The letter goes on to state that PGL had agreed to waive the entire administrative charges and interest on the subordinated notes for the year 1986. This forgiveness amounted to approximately $7,000,000 for FIC and AIC. The amounts were to be forgiven on the condition that FIC take PS&T out of all joint ventures and "development real estate" in order that FIC be in a position to manage the projects in its own self-interest and to thereby maximize its return. Thus, FIC would buy not only jointly held interests, but also assets owned solely by PS&T. The letter stated that this waiver and purchase of real estate amounted to a "contribution of capital" to FIC and AIC.

FIC and PS&T agreed that the latter would receive cash at the net book values of the assets as determined by reference to CDIC valuations. It was understood that if the Provincial Treasurer's Department had any objections, FIC would be entitled to reverse the transaction. John Cormie accepted the proposal on behalf of PS&T.

An Agreement of Purchase and Sale [Exhibit 292, Tab 2] was executed by FIC (Petracca and Marlin) and PS&T (Petracca, James Cormie and John Cormie). It is undated but effective December 31, 1986. In fact the agreement was executed in late February or early March, 1987. [9359] James Cormie testified that the transaction closed on March 6, 1987. [14336]

Prior to the letter agreement, PGL had approved the reversal of the 1986 administrative levies and subordinated note interest taken in cash from FIC and AIC. The PGL directors' resolution [Exhibit 288, Tab 1] is dated December 20, 1986, and signed by Donald Cormie, James Cormie, John Cormie and Marlin resolves that PGL waive subordinated note interest and levies for 1986 as follows:

	FIC	AIC
Interest	$1,799,102.30	$ 563,451.30
Levies	3,299,684.20	1,096,352.96
	$5,098,786.50	$1,659,804.26

The transaction was rescinded on June 29, 1987 pursuant to a demand from the acting Super intendent of Insurance of Alberta to FIC dated June 29, 1987. [Exhibit 292, Tab 3] It stated:

> In December 1986, First Investors Corporation Ltd. (FIC) paid approximately $9.2 million in cash in exchange for low or non-performing assets.
>
> It appears that this was a prohibited transaction under section 138 of the Trust Companies Act. In addition it has not been demonstrated to me that the assets purchased by FIC were authorized investments under the Investment Contracts Act.
>
> Accordingly, I consider this transaction may be prejudicial to FIC's investment contract holders and must be reversed.

The transfer price of the Properties was approximately at the value ascribed to them in July, 1985 by CDIC. Six of the Properties were transferred at CDIC value. Twelve of the Properties were transferred at CDIC value plus a 7% premium. CDIC value was thought to be net of sales commissions and legal costs; the premium recognized that there would be no such costs incurred in this intercompany transaction. I note that the benefit was not shared, but given in full to PS&T. One Property was transferred at CDIC value plus 3%. Seven Properties were valued at less than the CDIC valuation. Six Properties were not valued by CDIC and were transferred at amounts approximating or lower than appraised value. The remaining 5 Properties were transferred at prices based on management valuation. [Exhibit 292] Johnson testified that the values used were intended to be current market value. [6607]

Foreclosed property was purchased for $6,669,407. An additional $1,943,315 consisted of interests in the Okanagan Park loan (*infra*). The remainder of the $9,220,322 purchase price consisted of 3 small mortgages aggregating $607,600. [Exhibit 292, Appendix 19.A]

Johnson, PGL's Vice President of Finance, testified that he was absent when this transaction was structured. During his absence, his comptroller, Nicholson, contacted him and advised that PS&T was transferring a certain number of mortgages and owned property interests to FIC for values equal to CDIC values. The following is an extract from Johnson's testimony:

> Q What was your response to that?
>
> A Probably my exact words would not fit the demeanour of this room. [6601]

He testified that he was surprised at the transaction because the March, 1984 transaction (Transaction #1) had been severely criticized. He doubted that it was good business practice for affiliated financial institutions to transfer real estate among themselves. [6601] He testified that, in his mind, FIC and AIC were not empowered under the *ICA* to acquire real estate. [6597-6610]

The administrative levies and subordinated note interest were repaid to AIC by PGL with shares of Matrix (see Transaction #13, *infra*.) In the case of FIC, PGL repaid approximately $1,200,000 in cash in 1987. The other $3,800,000 of levies and note interest remained owing to FIC by PGL as at June 30, 1987. [Johnson, 7395-99]

John Cormie testified [9360-69] that the business purpose of PS&T in this transaction was that it had reduced its mortgages and real estate to about 15% of its asset portfolio, while FIC had been developing through its personnel expertise and talent in the development of real estate, namely Frazier and Petracca. PS&T did not have as concentrated an expertise. He added that there had been very conservative write downs on some of the Properties, that the book values now looked "highly marketable", and that Aboussafy felt that some of the Properties would have good upside potential. With this transaction, PS&T would lose the chance to share on the upside. However, from a management point of view, John Cormie felt the deal would be advantageous in the sense that PS&T could concentrate in its area of expertise.

John Cormie also testified that he understood from the outset that this transaction did not conform with the *Trust Companies Act* and "regulatory approval" would be required for consummation. [9522]

Petracca testified that she was familiar with this transaction but did not negotiate it. She was unable as a director of FIC to explain why it would execute a transaction that subsequently had to be reversed for illegality. It did not seem to her imprudent: FIC got $9,000,000 of property for a net cost of $2,000,000 after reversal of the levies. However, she could not explain why she, as a director, would want FIC to acquire more real estate, resorting to the excuse that she did not negotiate it. While she signed the agreement, she said she relied on Marlin and John Cormie. [11303-10]

Marlin [12243-54] testified that this transaction was in response to the same type of circumstances that affected FIC when it decided to enter into Transaction #1:

> . . . It was the same situation that had existed in the spring of '84 where CDIC were looking at the value of real estate and mortgages on a liquidation valuation, and First Investors was in the position of being tarred with the same brush.
>
> We felt that the transaction, by moving the properties involved, would improve the situation with CDIC and would put the properties into First Investors where they could be valued in a different valuation technique and where we could deal with them along with the other part of the properties, the other interests that First had in the properties, much more effectively. [12244]

He later testified that again, CDIC took a very hard stand on the values of Alberta real estate. He added that FIC was better equipped to work out of the real estate over a longer time. [13026]

The main motivation for the deal was, however, the CDIC valuation, oriented as it was to liquidation values:

> Q Just to be clear, the main motivating force here was CDIC's involvement with valuation again in the trust company?
>
> A Yes, that's what it would be. [12249-50]

Marlin testified that by "liquidation value", he did not mean forced sale value, but rather the current market value. [12250] He later conceded that it would not have been necessary to transfer the Properties to FIC and AIC to enable Petracca and Frazier to deal with them. [13519]

Marlin's evidence was that the transaction was good for FIC owing to PGL's agreement to waive the levies for 1986. [12246] He testified: [12247]

> Q Was it the fact that you were going to forgive the levies and subordinated notes interest in any event and just trying to find a mechanism by which to do it and to present it?
>
> A I would think that that's — the way you put it, is probably true.
>
> Q Okay. So this transaction is set up on the basis that the levies and subordinated notes interest are going to be forgiven, that would create a debt, and to satisfy the debt, you had to set up some sort of mechanism to do it, right?
>
> A That's correct, yes.
>
> Q You are not going to pay the cash back?
>
> A No.

He testified [12252] that while there was no discussion whether or not this was a permitted trans action in respect of s. 138 of the *Trust Companies Act*, it was decided that if the companies were unable to satisfy the regulatory authorities or comply with their requirements, then it would be reversed. He subsequently testified that the fact that the previous transfer (Transaction #1) had not been re versed affected the decision to go ahead; that is, it might work again. Further, he said, regulatory pressure over Transaction #1 was the reason why this transfer was not done at book value. He testified that in deciding to proceed with this transaction, he had meetings with Donald Cormie and John Cormie. [12253] The external auditor also assisted in assessing market values. [12254]

Under cross-examination, Marlin gave the following evidence:

> Q So would you explain to us why in December of 1986, FIC and AIC are acquiring yet an additional 39 properties at book value for cash?
>
> A Because the investment contract companies were geared up to handle them better than the trust company, Number 1.
>
> Q Just let's pause with that. How is that? How are they geared up to handle them?
>
> A We had staff that could deal with them. Christa Petracca was one who was concentrating on the real estate, and so was Lance Frazier.
>
> Q But they didn't work for FIC and AIC, we know that.
>
> A No, but they were working on a special assignment or special project to deal with that real estate.
>
> Q Couldn't somebody carry the PS&T files into their offices? Did you have to transfer the property to FIC and AIC before Petracca and Frazier could look at them?
>
> A Yes, that's true, they could have.
>
> Q Could have. All right. So there is Reason 1. What's Reason 2?

A Reason 2 is that the valuation of the real estate by CDIC was on a different basis because of the liabilities of the trust company being different than the liabilities of an investment contract company. The valuation techniques were different.

Q So to save the trust company, you were prepared to have the contract companies pay cash for a bunch of properties that weren't worth their book, right?

A Well, you have to take into consideration —

Q Is that right or not?

THE INSPECTOR: The question is quite simple, Mr. Marlin.

A All right. Ask it again, please.

Q Mr. White: In order to save the trust company, you were prepared to have the investment contract companies pay cash for a bunch of real estate that wasn't worth its book, right?

A Yes, that's correct. Can I now elaborate a little bit?

Q I'm sure if your lawyer wants you to elaborate, he will ask you later. Right now we will answer my questions. [13518-20]

Marlin elaborated during re-cross examination by Mr. Duke; he testified that the deal was being done for the benefit of PS&T, but also was a good deal for both companies and did not prejudice FIC. [13686]

James Cormie testified [14329-54] that the PGL directors' resolution dated December 20, 1986 [Exhibit 288, Tab 1], which reversed the levies and interest, was contingent upon this transaction which was struck in February, 1987. He was not able to say whether the minute was backdated. His evidence is unsatisfactory on this point. Immediately after testifying that he understood the waiver was contingent on this transaction, he gave the following evidence:

Q Are you telling us that it was backdated?

A I am not sure, it might have been. That is possible.

Q So you don't know whether it has been backdated or not?

A No, I don't.

Q If it wasn't backdated, it couldn't be contingent on the deal struck in February, could it?

A That's correct, but my understanding was is that it was contingent on the deal in February.

Q Was the letter in February the first time that the proposition was put forward that the levies and interest would only be waived if the contract companies bought the mort gages from the trust company?

A That's correct. [14331]

He also testified that the concept of the transaction was developed in discussions among the directors of FIC, PGL and PS&T. The outside auditors were involved in assisting in establishing the transfer values for the Properties. [14332-3] He further testified that the transaction was a sale and he knew it was prohibited by s. 138 of the *Trust Companies Act*. Nevertheless the transaction proceeded subject to regulatory approval thereon. [14338]

It is clear from the documentation that the resolution was not backdated. That resolution waived interest due on notes and the levies both in relation to FIC ($5,098,786.50) and AIC ($1,659,804.26). The AIC transaction will be described in detail later, but the following details tend to show that the resolution was not backdated. AHL resolved on December 20, 1986, at the hour of 9 o'clock in the forenoon, according to the face of the minute, that it would assume the liability of PGL to AIC. Another

AHL minute dated December 20, 1986, at the hour of 11 o'clock in the forenoon, according to the face of the minute, resolved that AHL tender shares of Matrix as full and complete settlement of the debt due to AIC. By letter dated December 20, 1986, signed by Donald Cormie, AHL confirmed with Allarco (a subsidiary of AHL) that Allarco had "loaned" 1,276,772 shares of Matrix to AHL. The working papers of Peat Marwick Mitchell in relation to the 1986 AHL audit (dated February 13, 1987) show that the transfer to AHL was made on December 20, 1986. Finally, a promissory note relating to that transaction was also made and dated December 20, 1986. [Exhibit 288]

That the resolution is not backdated is consistent with Marlin's evidence that while PGL was prepared to waive the subordinated note interest and levies, it was not prepared to repay with cash. It had to find some other sort of consideration and in the case of FIC it was mostly foreclosed real estate. James Cormie maintained his denial of this. [14350] James Cormie's evidence was that the benefit to FIC of the transaction was the amount of levies waived. [15027]

Donald Cormie testified that the board of PGL understood that its resolution of December 20, 1986 was conditional upon FIC agreeing to do Transaction #19. He could not say whether the resolution was backdated. [17516-26]

Donald Cormie testified that the motivation for this transaction was different than in Transaction #1. The Properties owned solely by PS&T were a "gift" to FIC. In his recollection, those Properties were transferred at about $4,200,000 — his figure is approximately correct. If $4,200,000 cash were paid to FIC for taking those Properties, it really got them for nothing. Thus, according to Donald Cormie's theory, if the levies were waived and the cash restored to FIC, there was a "gift". [17530-35]

In his testimony Donald Cormie stated that when he approved this transaction as Chairman of the board of PS&T, he did not understand that it would contravene s. 138 of the *Trust Companies Act*, apparently because he considered the transaction to be a "gift", not a sale. When confronted with the Agreement of Purchase and Sale, Donald Cormie said that the agreement did not properly carry out what was intended to be done pursuant to the letter agreement, should never have been done, and was a mistake. He testified that while he was a party to the decision as described in the February 24, 1987 letter, he was not aware of the Agreement of Purchase and Sale in detail and stated: "I wasn't aware that this transaction was put through in what appeared to be some kind of a binding form". [17534; 17712-20]

Donald Cormie testified that he had discussed with the auditors whether the transaction could be backdated to December 31, 1986 and that he was aware that the payment had been recorded on the books as at year end. [17720-21]

Donald Cormie testified that he was a party to [17719] and helped draft the February 24, 1987 letter [18925] and was therefore aware the proposal was being made. From here the evidence respecting Donald Cormie's vision of the transaction as opposed to how it was actually done becomes difficult to follow. He said he authorized the transaction because it would be better, given PS&T's small property holdings, for one company to have all the Properties if that company would not be hurt by the transaction. About $4,500,000 of the Properties were owned solely by PS&T. If PGL gifted a corresponding amount to FIC then the transaction might be legal since FIC would get those Properties for free. The joint interests were apparently to be transferred by a tender or some legal method to be worked out, adjusted to CDIC value, and any valuation difference would be covered by the remainder of the waived levy. [17727; 17531; 18925-30; 20476] He also said FIC should not have paid the $9,200,000, but speculated the payment was made in order to book the transaction in the 1986 year end. [22116]

I pause to note that the evidence in respect of Transaction #1 was that a tender had to be at book value. I cannot accept Donald Cormie's evidence that he believed there was some other legal method that could be worked out to facilitate the transaction. I also cannot accept his evidence that the transaction was not to be put through in some "binding form". That is exactly what was contemplated by the letter agreement.

Donald Cormie later testified that he did not approve the transaction; he was simply in favour of it and disavowed his earlier answers on the basis that either the question was tricky or the answer needed further elaboration. [22101-07] In any case, the evidence is clear that Donald Cormie authorized the concept of the transaction, which according to the February 24, 1987 letter which he helped draft, involved a $9,200,000 cash payment to PS&T. [Exhibit 292]

It is notable that the February 24, 1987 letter refers both to FIC and AIC. Donald Cormie was a party to the February 24, 1987 letter. He testified that at the time this deal was designed he had not realized that the repayment of the AIC levy had already been dealt with. Donald Cormie denied that the real purpose of this transaction was to remove poor assets from PS&T and place them in FIC and AIC. [22113]

I accept that when the PGL directors' resolution was executed on December 20, 1986 the directors contemplated some sort of transaction to repay the debt which arose upon "forgiveness". I do not accept that this transaction was designed to be a capital contribution or a gift. Had PGL wished to make a gift, it could have paid the monies to PS&T on behalf of FIC, plus payment to FIC of compensation for any expenses to be incurred on the Properties such as taxes, maintenance and insurance. Instead, FIC was not compensated for such expense and lost over $9,000,000 in liquidity (an annual loss in earning power of $1,800,000 at 20%). In return it received foreclosed real estate which, in addition to being illiquid, was low or non-performing.

There is no documentary evidence that PGL intended to repay the entire waived levies and subordinated note interest to FIC in cash. There is also no credible explanation why PGL did not repay the total amount owing in February or March, 1987 even though FIC paid the total amount of the purchase with PS&T in cash. It is unlikely that the entire "forgiven" amounts were to be paid in cash and indeed, as in all other cases except Transaction #1, the board of PGL was considering exactly what asset would become the medium of exchange. I cannot find what FIC might have received for the balance of the payment due because its collapse intervened on June 30, 1987.

I do not accept the evidence of the witnesses that they intended to proceed with the transaction subject to "regulatory approval". They did not seek approval; rather, they proceeded subject to the regulators insisting that what the evidence tends to show was an illegal act be reversed. I do not accept Marlin's evidence that violation of s. 138 of the *Trust Companies Act* was not considered. The evidence tends to show that the board of directors of PGL all knew the contemplated procedure was illegal under that statute.

The evidence tends to show that the reason for this transaction was to benefit PS&T by removing assets of questionable value from PS&T, during a time when the federal regulators continued to pressure it to adhere to more sound business and financial practices. The reasons expressed in the letter dated February 24, 1987 are not credible. Only 9 of the 37 Properties were jointly held. It was not necessary to transfer the real estate to FIC to enable the functional managers to work on it. PS&T had an officer, (Aboussafy) engaged in real estate disposal. As noted hereafter, PS&T had participated through 1986 and to February, 1987 in the Lake Okanagan Park troubled loan workout with no apparent conflict with FIC and AIC. PS&T acquired real estate (the Derrick Plaza) and was "selling" real estate in late 1986 (Trans action #14). The previous waiver of the administrative levies and subordinated note interest was linked to this transaction in an attempt to deflect criticism that the transaction harmed FIC.

The evidence tends to show that Marlin and Petracca both of whom executed the Purchase and Sale Agreement on behalf of FIC, and Donald Cormie, who participated in and approved the February 24, 1987 proposal, acted in a fashion that unfairly disregarded and prejudiced the interests of the security holders of FIC and AIC. I have considered Petracca's evidence that she relied on others to ensure the transaction was prudent. However, reliance cannot be blind. She was fully aware of the history of Transaction #1 and there is no reason why FIC ought to have entered this transaction. As she is not a PGL director, however, she may have believed that FIC would be receiving the amount of the waived levies and subordinated note interest in cash. Thus while the evidence tends to show that her conduct in these circumstances was prejudicial to the investment contract holders; nevertheless the evidence sometimes tends to show conduct of lesser gravity and this is such a case.

The evidence tends to further show that the board of directors of PGL acted dishonestly in relation to FIC by disregarding FIC's interests in favour of PS&T and by committing, with full knowledge, what the evidence tends to show was an illegal act on the part of PS&T, namely, violation of s. 138 of the *Trust Companies Act*.

TRANSACTION #5

In June, 1985 PS&T, FIC and AIC sold 6 owned properties and 2 mortgages (under foreclosure) to General Equities Holdings Ltd. ("GE"), an unrelated third party. The transaction was structured as follows. [Exhibit 282; 6460-99]

First, PS&T loaned $10,000,000 to Shucksan Properties Inc. (a wholly-owned subsidiary of GE and referred to herein as "Shucksan") which had no other assets or liabilities. The loan was made June 17, 1985 pursuant to the Master Loan Agreement between Shucksan and PS&T. It was repayable on demand with interest payable annually at the rate of prime minus 3%. Shucksan used the funds to purchase Government of Canada bonds, which were then pledged to PS&T as security for the loan. The Pledge Agreement provided that the pledgee, PS&T would not assign or transfer the bonds. But it did. Therefore, the bonds were made the subject of a Managed Trust Agreement between PS&T and Shucksan dated July 11, 1986, but made effective August 31, 1985. PS&T was empowered under that agreement to buy and sell the bonds, to convert them to cash and to reinvest all cash and other forms of the trust assets in any form of investment determined by PS&T in its sole discretion. The Agreement specifically provided that the investment could include units of PBF. The investments could be, and were, made without Shucksan's consent. PS&T was entitled to any trading gains realized, as a management fee. The trust assets were also pledged as security for the below-described mortgages.

Secondly, in June, 1985 GE purchased the Norscott Shopping Centre in Surrey, British Columbia (the "Shopping Centre") for $4,850,000 from an unrelated party. To fund the purchase, FIC lent GE $6,080,250 at an interest rate of 6½%. The interest was payable annually. The principal was due at the end of 5 years. The security for the loan included a fixed charge on the Shopping Centre and a floating charge over all the assets of GE. As well, FIC took a pledge of shares of Shucksan, an assignment of rents derived from the Shopping Centre and a chattel mortgage on all assets owned and used by GE in the Shopping Centre. The loan was also guaranteed by Shucksan, which assigned the income from the pledged trust assets as security for its obligation, subject to the prior charge in favour of PS&T as security for its $10,000,000 loan. FIC had an option to purchase a one-half interest in the Shopping Centre should an offer to purchase it be received from a third party.

The remaining $1,230,250 of the loan proceeds was used for the downpayments on certain properties purchased by GE from FIC, AIC and PS&T and the payment of legal expenses.

On June 17, 1985, GE purchased 6 owned properties and 2 mortgages from FIC, AIC and PS&T (in this discussion about Transaction #5, the "Properties" or where applicable, the "Property"). PS&T, FIC and AIC received a downpayment of approximately 10% of the purchase price. The downpayments were funded out of the proceeds of the FIC loan to GE [3817-19]. The lenders also took a vendor takeback mortgage on the remaining 90% of the purchase price for each of the Properties. The principal on the vendor takeback mortgages was due at the end of 5 years. Interest only was due annually at prime minus 3% per annum on the PS&T vendor takeback mortgages, and at 6½% per annum on the FIC and AIC vendor takeback mortgages. These loans were also guaranteed by

Shucksan and collaterally secured by an assignment of income from the pledged trust assets. Each vendor had the option to purchase a one-half interest in the Properties should an offer to purchase be received from a third party. The cash flow produced by the Properties was not sufficient to service the debt owing and secured by the vendor takeback mortgages at June 17, 1986. [6473] Subsequently, 2 PS&T vendor takeback mortgages were split and $1,000,000 of them were assigned to 321635 Alberta Ltd. in partial payment of the purchase price of Derrick Plaza (Transaction #14, *infra*).

According to a legal opinion dated February 11, 1986 the trust assets were pledged as security for the Shopping Centre loan and each of the vendor takeback mortgage loans.

The Properties and their appraised value are as follows:

Company	Property	Sale Price	Mortgage	Non-Distress Market Value	Date of Appraisal
PS&T	Greek Tycoon	3,901,000	3,510,000	1,050,000	May, 1984
	Pathfinder	1,501,000	1,350,000	330,000	July, 1984
	Tow-Mor	651,000	585,000	354,500	Sept., 1983
		6,053,000	5,445,000	1,734,500	
FIC	Pembrooke	631,000	567,000	600,000	Dec., 1982
	Racquet Club	1,201,000	1,080,000	525,000	Oct., 1984
	Thorncrest	2,046,000	1,840,500	585,000	Aug., 1983
	Brooks	651,000	585,000	589,000	May, 1984
		4,529,000	4,072,500	2,299,000	
AIC	Lougheed	1,631,000	1,467,000	930,000	Sept., 1983
TOTAL		12,213,000	10,984,500	4,963,500	

There is no evidence that any of the Properties were jointly held prior to this transaction.

The loans to GE were non-recourse, and on default the remedies were in effect restricted to the security. GE would share in profits but could not incur losses. [3821-2; 3908]

The interest rates charged on the mortgages were under market rate and could be characterized as a "special deal". Johnson testified that the Shopping Centre was appraised in excess of $8,000,000, although the methodology used in the appraisal caused him some concern. [6468-71] According to audit working papers [Exhibit 282, Tab 11] the Shopping Centre was appraised at $8,107,000 as at May, 1985. The appraisal itself is not in evidence.

FIC suffered a loss on sale of the Properties. It was, however, able to decrease its net reserves (provisions for loss which decrease income), thereby increasing its income by $415,996. PS&T realized a gain on sale of the Properties and also decreased its reserves by $15,000. Its income was thereby increased by $128,788. AIC suffered a loss on sale of its Property of $6,064. Its reserves were unaffected. In addition, PS&T eliminated $500,000 of appropriation of retained earnings and FIC eliminated $100,000 of such appropriation. However, in the case of FIC, Deloitte Haskins & Sells qualified its audit opinion by the amount of $200,000 relating to the valuation of the Properties in question. As is noted elsewhere, "appropriations" to retained earnings were established where an underlying security of a mortgage or an owned property had suffered a decline in value which, owing to some expected economic recovery, was considered temporary. Unlike reserves, which were expenses charged to the income statement, appropriations did not affect the income statement, but rather were found in a note to the financial statements. As also noted elsewhere, Deloitte Haskins & Sells qualified its audit opinion in 1985 on the financial statements of, *inter alia*, FIC, owing in part to the valuation of real estate. [Exhibit 282; Appendix 5A; 6473-75]

In a December, 1986 economic analysis prepared by GE, it was estimated that the sale value of the Properties less estimated development costs would be $7,945,000, which was $4,268,000 less than the purchase price paid by GE. It was estimated that upon the sale of the Shopping Centre, $4,876,000 net would be recovered, resulting in a net gain on the entire package of $608,000. [Exhibit 282, Tab 15] It is clear that FIC, AIC and PS&T were attempting to apply anticipated gains on the Shopping Centre to offset losses on the owned properties and troubled mortgages that would otherwise have to be recognized.

As noted above, Shucksan had no other assets or liabilities except for the bonds assigned to PS&T and the $10,000,000 demand loan. Clause 4.3 of the Loan Agreement [Exhibit 282, Tab 2] provided that the loan was to be advanced to Shucksan to be used for payment of and only for payment of the purchase price for the bonds and that the type of bonds, their method of selection, their rate of return and the seller thereof required the approval of PS&T, which approval could be arbitrarily withheld. The pledge agreement provided that the pledgee, PS&T, would not assign or transfer the bonds unless the assignee or transferee of the bonds agreed to be bound as if an original party to the agreement. The Managed Trust Agreement dated July 11, 1986 between Shucksan and PS&T enabled PS&T to trade the trust assets and provided that the trustee would be entitled to retain for its own use the difference between the amount realized on the conversion of any trust assets into cash and the original acquisition costs, provided that any amount received on such conversion which could be fairly attributed to income or yield would remain as part of the trust assets. [Exhibit 282] The bonds paid interest at 10 to 15% per annum. [Johnson, 6463] Another witness, as noted below, said they earned about 9.8% per annum.

As of January, 1988 the vendor takeback mortgages still existed, and all of them were in default. The Shopping Centre mortgage was in default. The liquidator of PS&T collapsed the $10,000,000 loan and PS&T ultimately recovered at least its principal (whether it recovered interest thereon is not in evidence). [6479-80]

As at June 17, 1986, the first due date for interest payments, $1,945,418 was owing in interest, legal fees and taxes on all the loans (Shopping Centre, Shucksan, and vendor takeback mortgages). GE paid on June 24, 1986 cash in the amount of $450,000. The balance of the amount due was paid from income from the Shucksan fund ($925,440), redemption of units of PBF owned by the Shucksan fund ($568,559), and the application of some cash in a trust account ($1419). The capital of the trust fund was now, owing to the redemption, less than the loan due from Shucksan. [Exhibit 282, Tab 1]

Johnson testified that he was told that the purpose of the transaction was to move the properties to the hands of better property managers. [7534-8; 7104-5] After the fact and over time he concluded that GE were not better managers, or even as good, as those within Principal Group. [7104]

Aboussafy testified that obtaining property management expertise was an object of the deal. In his opinion such expertise could only be obtained by providing incentives, rather than by simply hiring personnel. He was satisfied that the deal had a genuine business purpose. [4063-6] Aboussafy had earlier been asked whether professional managers could be hired and his response was simply that with the internal systems of the Principal Group it would have been very difficult to spend money to get such managers "up to speed". [4010-11]

Aboussafy also agreed that another object of the transaction was to avoid reserves or write downs. He also agreed that the inflow of cash to the Principal Group, were it not for the excess cash from the Shucksan bond fund (established through a PS&T loan) was nothing. [4007-10] GE wrote to Aboussafy in March, 1987 as follows: [Exhibit 245]

> [the auditors] will not, unfortunately, accept this sale from an accounting point of view, thus negating the original intent of the Agreement, i.e., save costly write downs whilst the properties were being "worked out".

Aboussafy testified that this transaction required Donald Cormie's approval to proceed. [4016]

John Cormie [9285-9302] testified that this "program" was conceived by George Aboussafy in discussion with John Cormie and that the two of them were largely responsible for its execution. The business purpose of the transaction, according to this witness, was to create a blanket mortgage combining both strong and weak properties. In this case, the strong property, rather than a high yielding piece of real estate, was to be bonds. In addition, the transaction placed the properties in the hands of experienced managers with ability to dispose of low-performing and non-performing assets. Finally, he said, if the "program" did not fully recover the real estate values, it was thought that there would be sufficient gains from the bonds to cover the difference. He testified that the average interest rate on the bonds was approximately 9.8% per annum, and the income therefrom could and would be used to fund shortfalls on the properties that could not service the debt.

John Cormie testified that in lending at favourable rates on the security of mortgages, he expected CDIC to discount the value of the loan package. Thus, while PS&T was able to eliminate reserves in the amounts previously stated, he testified that he expected the loan package to be reserved on a "rate basis" in any event. [9291] The implication is that the transaction would not and was not intended to have a significant effect on the financial statements. However, under cross-examination, John Cormie agreed that in part the transaction was a balance sheet salvaging operation. [9709]

Another motivation for the transaction, the evidence tends to show, is that PS&T was prevented by CDIC matching formulae from holding large amounts of long-term bonds. This transaction was structured through the Shucksan loan such that PS&T was not holding long term bonds, but rather a demand loan secured by bonds. The effect was mostly the same since PS&T was entitled to keep the trading gains. [Johnson, 6480-1; 6491-3]

Marlin testified that this transaction was beneficial because: first, it placed the properties in the hands of developers who had a track record of upgrading and improving properties; and secondly, it "firmed up" the value of the properties that were on the books of FIC, AIC and PS&T by creating a sale. He agreed that it also avoided a year end write down. He testified that, ultimately, this was a decision of the PGL board of directors. He noted that it was obvious that GE had no risk. [12105-15; 12979-80]

James Cormie testified that part of the original intention of the Shucksan trust fund was to use bond income to fund payments owing on the debts. He said the purpose of the transaction was to put professional management into the properties. His evidence was that the decision as to whether FIC or AIC would do the transaction was not one made at the board level of PGL. [14206-19; 14984-5]

Donald Cormie testified that this transaction would be discussed at the PGL board level because 3 companies were involved and would require his approval to proceed, particularly for the Shucksan loan. He believed the transaction to be beneficial for the PGL subsidiaries. GE was a good developer so far as known, and there was an upside potential on the Shopping Centre loan (that is, FIC's opportunity to participate in a sale) and the bonds. He stated that a business purpose in doing the transaction was to maintain the appearance of or the recording of values on the books in order to avoid write downs on the properties. [17395-406; 18851-65]

CDIC was unimpressed with the transaction. Its assessment of the transaction was that 10.8% of PS&T's assets were now earning interest at a rate far below market rates, and that the transactions did not improve its position. Accordingly, CDIC proposed to deduct the full amount of the provisions for loss as originally recommended by Department of Insurance Canada examiners for the three properties involved in the deal. However, CDIC did agree that the Shucksan bonds, for the purposes of the mismatch formula (a formula that established reserves on PS&T's capital when it failed to match assets and liabilities as to term), could be counted as a demand loan. [9301-2; Exhibit 363 at 119]

The vendor takeback mortgages, the Shopping Centre loan, and the Shucksan loan had all been recorded in the books in 1985. The auditors returned to this transaction in 1986. [Exhibit 282, Tab 11] No properties had been sold during 1986. GE had only paid $450,000 on accrued interest on the mortgages. A further $350,000, the auditors understood (and as noted earlier the true figure is higher), was covered by selling off some of the bonds and using the proceeds (not gains) to pay in full the amounts receivable. The auditors noted that after many hours of discussion with Aboussafy, John Cormie and James Cormie ("trying to get to the bottom of this deal"), and with the president of GE, it became evident that GE did not put 10% down on the properties in the first place, and that GE was only paying over the net cash flows of the properties, after paying for repairs, renovations and so on. The auditors noted:

> Whilst we cannot prove it, it is highly doubtful that GE have put any money into the deal since the "sale". George Aboussafy has insisted all along that GE have been putting their own money into the deal to the tune of (approximately) $400,000; however, I would expect that the income from all the properties would amount to $200,000 to $300,000 over and above the $450,000 paid over by GE — more than just a coincidence in my view. (Incidentally, nobody ever informed us last year or this year as to the real aspects of the GE deal insofar as to how much GE did or did not have in the deal — all along, George and John insisted that this was a bona fide deal.) [Exhibit 282, Tab 11]

Moreover, James Cormie was recorded in these working papers as informing the auditors that GE never had any intention of paying over more than the net cash flow of the properties, in direct contrast to what John Cormie and George Aboussafy had told the auditors in relation to the 1985 and 1986 audits.

The auditors concluded that no deal ever took place because:

1. GE did not put any money in up front;
2. GE probably had not put any money in since the deal commenced;
3. GE had no risk associated with the deal;
4. GE had no risk or benefits associated with the bonds;
5. GE had potential upside on the mortgages, but no more or no less than if they were simply managing the properties on behalf of the companies with a profit sharing clause. [Exhibit 282, Tab 11]

It was concluded that the Shopping Centre mortgage was valid. The other mortgages were rewritten on the books of FIC, AIC and PS&T to record the mortgages and owned properties as if the "sales" had never taken place. The Shucksan loan was re-written to record the bonds as assets, and the income therefrom as capital gains or interest income, as the case may be. In short, the auditors reclassified the vendor takeback mortgages as real estate and mortgages, and reclassified the demand loan as government bonds or PBF units, as the case may be. [6498-9]

McCutchen, the audit partner on this audit, testified that in 1985 he asked Aboussafy, John Cormie and Donald Cormie whether GE used its own money for the 10% downpayments on the purchased assets. He was told that all of the mortgage funding for the Shopping Centre mortgage went toward the Shopping Centre purchase. Since the appraisal on the Shopping Centre was in excess of $8,000,000, and the funding on the Shopping Centre was $6,000,000, being 75% of the appraised value, he concluded that GE made the downpayments on the other purchases from its own funds. As a result, FIC, AIC and PS&T (on the whole) were able to decrease reserves and record a small gain on the sale of the assets. [24645-48]

Johnson testified that during 1985 he understood, as did the auditors, that GE was at risk to make the mortgage payments. However, when the capital of the Shucksan trust fund was used to pay the shortfall on the Shopping Centre loan and the interest on the vendor takeback mortgages in June, 1986 he became aware that, in fact, GE was not at risk. [6496-9]

John Cormie testified that he could not recall the nature of his discussions with the auditors in 1985 and stated that perhaps there was a discussion that related to the favourable interest rates and any consequent effect on valuation. He was unsure of what year that had occurred. He agreed that it was possible that Deloitte, Haskins & Sells were not aware that GE was not at risk. He could not recall the issue of non-recourse financing coming up. [8292-3]

James Cormie testified that the only contact he had with the auditors was in early 1987, when he told them that he was disappointed with GE because it had not sold off some of the properties as originally hoped. [14984]

Donald Cormie testified that while GE was not at risk in the transaction, that was something that was not "fully" known to him going into the deal. He stated that he did not "really examine" that aspect, was not familiar with it, and found out later on when the auditors raised it that GE was not at risk. [17401-6]

Donald Cormie also testified that he had not realized what the purchase price of the Shopping Centre was. [17396] He later testified under cross-examination by counsel for the auditors that there was no failure in this transaction to give complete details to the auditors, although he was aware that such an allegation had been raised in some later document. He also testified that he was not aware that the auditors were told that GE contributed its own money to make the 10% down payments. [20660-64]

As noted, it was determined by the auditors in respect of the audit for the year ended 1986 that the GE transaction should not have been treated as a sale. Having reviewed the applicable working paper, which was prepared by the audit manager Barnes, McCutchen discussed the matter with John Cormie and subsequently with Donald Cormie. Those discussions confirmed that GE did not put its own money into the initial deal. He did not recall any discussion why that fact was not disclosed to him in the prior year. [24685-90; Exhibit 538 at 105]

I accept the evidence of McCutchen. I find that the evidence tends to show that John Cormie and Aboussafy were dishonest in the disclosure they made to the auditors. If Donald Cormie was aware of the nature of the downpayment, then he gave the auditors false information or concealed certain information. If he was not aware of the source of funding for the downpayments, and one accepts his evidence that he was not aware of that aspect of the transaction, he nevertheless gave an answer to McCutchen. That also is evidence tending to show conduct that was dishonest since it would be a statement made recklessly, not knowing whether or not it was true.

The witnesses have testified that the transaction was beneficial because problem properties were being placed with persons who had applicable expertise. Moreover FIC, AIC and PS&T got to share on the upside to the extent of 50%. On the other hand this transaction was questionable from the perspective of the Principal Group for the following reasons.

First, the transaction involved the purchase of a shopping mall unrelated to the Principal Group. FIC advanced funds at a rate of return less than its own cost of funds and making up a very large proportion of its capital base. There is evidence that GE was not necessarily a better manager than the property managers within the Principal Group [7104], although according to the audit working papers the independent auditors accepted that rationale as reasonable. The justifications advanced by management in relation to Transactions #1 and #19 emphasized the expertise of FIC and AIC in working out problem properties (in particular, the expertise of Petracca and Frazier). These justifications are inconsistent with the stated purpose of this transaction. Moreover, I note that PS&T was able to contract for management of Derrick Plaza in the case of Transaction #14. Finally, GE and Shucksan were incorporated solely for the purposes of the transaction and were required to contribute nothing except effort. There was no risk to GE and Shucksan.

I also note that the Principal Group undertook workouts of properties of far more significance than these, including Lake Okanagan Park, Kona, the Rimrock Hotel and the Prince Royal Inn (*infra*). FIC also had a property manager (Burke) for income producing properties.

I find that obtaining some outside management was a collateral but relatively unimportant motivation in the transaction. Its prime motivation was to avoid write downs on the books of FIC, AIC and PS&T, the subsidiaries of PGL which owned real estate, and to allow PS&T to continue in the bond trading business while at the same time avoiding any additional capital requirements which would be imposed on it through the operation of the CDIC mismatch reserve.

Apart from avoiding write downs and reserves, the transaction had little effect on AIC. FIC, however, gave up $6,080,250 in cash to GE as a loan. It received $456,000 back in the form of a downpayment. The balance of the money earned interest at 6½% per annum, which was below its cost of funds. [6467] Donald Cormie wrote a memo to John Cormie in February, 1986 stating as follows:

> I think in addition you should push to get the $6 million downpayment back on the General Equities Ltd. deal so that we can get this money out into the market. [Exhibit 244 at 83]

Donald Cormie wished to withdraw from the transaction only 9 months after it had been executed because the Properties were not being sold as anticipated. He is also the person who required that owned properties be valued over a 7 year time horizon on the theory that they could not be sold for their proper value in the short term. He could not possibly have anticipated that there was a reasonable chance of GE disposing of these Properties quickly. GE had the ability, however, to do something that FIC and PS&T could not. If FIC or PS&T sold certain of the Properties into the soft real estate market, they would suffer a book loss. If GE sold a Property at a loss the companies might be able to re-negotiate the loan applicable to that Property and maintain it at book value by relying on the excess equity in the borrower's other assets. In particular this borrower now owned the Shopping Centre, with an appraised value of $8,107,000 and therefore purported equity of approximately $2,000,000. The concept is not significantly different than some of the intercorporate share transactions which are discussed below.

Finally, FIC was poorly secured. Its $6,080,250 loan was secured by the Shopping Centre. It is obvious that the equity, if any, in the Shopping Centre would be supporting the other loans. FIC could only be fully secured if GE, which had no risk on the transaction, was able to improve that property and sell it. The share pledge of Shucksan shares and the guarantee from Shucksan were worthless and known as such to all parties when the deal was conceived and made. The only asset Shucksan had was the $10,000,000 in bonds, which was already pledged as security for the PS&T demand loan. There was no equity in the trust assets because the loan was 100% financed. By spring of 1986 the market value of the bondholdings was approximately $9,950,000, an amount less than the Shucksan loan. [Exhibit 282, Tab 1]

The transaction, at least from FIC's perspective, was high risk, and demonstrated the length to which these companies and their management, Donald Cormie and Marlin, would go to salvage the balance sheet at the expense of cash.

TRANSACTION #3

The series of transactions which occurred pursuant to an agreement dated June 29, 1984, may be summarized as follows. [Exhibit 281]

First, AHL acquired all the shares of Allarco Energy Ltd. ("Allarco") for $17,250,000, all the shares of North West International Bank and Trust Company (the "Bank") for $19,800,000, and 50% of the shares of Travellers Acceptance Corporation Ltd. ("Travellers") for $1,000,000 from Allarco Group Ltd. ("AGL"). It paid for the assets by issuing from its treasury 36,340,000 preferred shares at $1 each ($36,340,000), and transferring 68,400 PGL 6% second preferred shares with a par value of $25 each ($1,710,000), for a total consideration of $38,050,000. The Bank was registered as a Schedule "B" bank in the Grand Cayman Islands. Allarco was an oil and gas company with virtually all of its operations in Alberta.

Secondly, FIC and AIC purchased the $36,340,000 of AHL preferred shares from AGL for $1 each. FIC and AIC paid for the shares by:

a) transferring the Venture Properties Securities (which are described below) for $7,800,000 to 314986 Alberta Ltd. ("314986"), a wholly-owned subsidiary of AGL incorporated on June 5, 1984;

b) transferring Carma Developers Ltd. debentures at face value, $2,700,000, to AGL;

c) transferring Nu-West Group Ltd. debentures at face value, $4,800,000, to AGL;

d) crediting to the purchase price to be paid by 314986, under the Agreements for Sale described below, the sum of $5,840,000;

e) paying cash of $15,200,000 to AGL.

Thirdly, PGL redeemed or repurchased its second preferred shares from AGL in the amount of $1,710,000 and paid for the shares with Carma Developers Ltd. debentures at face value ($975,000) and Nu-West Group Ltd. debentures at face value ($735,000).

Fourthly, FIC and AIC sold 7 owned properties to 314986 for $21,040,000 (book value $23,360,000 net of prior charges of $2,320,000) under Agreements for Purchase and Sale. After credit to purchase price of $5,840,000, the sum of $15,200,000 was outstanding under these Agreements. Five properties were income producing and 2 were raw land. [7525-6]

Fifthly, FIC and AIC lent $2,000,000 to 314986. $1,500,000 was advanced to 314986 and $500,000 was paid to PGL on behalf of 314986 for deposit in a sinking fund account with PGL. In return, PGL issued a $500,000 promissory note to 314986, which note was then pledged to FIC and AIC as security for the loan, along with a mortgage on the Venture Properties Securities.

The loan to 314986 bore interest at 14.3% per annum. Interest was payable annually from June, 1984 to June, 1986. The principal sum was due in a single payment on June 29, 1986. PGL was obliged by the terms of the Master Sale Agreement (which was, as the name suggests, the agreement pursuant to which all of the transactions were carried out) to pay sufficient amounts from the sinking fund account to cover the interest due on this loan. The remedies of FIC and AIC on this loan were limited to the sinking fund account, the Venture Properties Securities, and any related securities on the Venture Properties Securities.

In summary, FIC and AIC disposed of:

1. Venture Properties Securities, $7,823,157, being book value of the Venture Properties Limited loan. The Venture Properties Securities were two mortgages on downtown Calgary property granted by and to secure a loan to Venture Properties Limited, two guarantees of its share holder, Paul D. Kuffler, foreclosure actions on both mortgages and legal actions on both guarantees. The Venture Properties had an appraised value of approximately $2,600,000 and Touche Ross & Co. had required FIC and AIC to establish an approximate $4,400,000 contingency for loss against the loan for the year ended 1983. [Exhibit 281]
2. Carma Developers Ltd. and Nu-West Group Ltd. debentures, $6,259,586.
3. Cash $17,200,000.
4. Real properties (net of prior encumbrances), $21,040,000.

AIC and FIC acquired:

1. AHL preferred shares, $36,340,000 at $1.00 each. These shares carried a 4% dividend rate with additional participation up to 70% of Royal Bank prime. [Exhibit 319] Participation never occurred [14166; 17292] although it was possible the earnings would rise over a few years to engage that clause. [14166] The 4% rate equated to the "guaranteed" rate on investment

contracts. [17283; 18844] The preferred shares were not retractable (that is, FIC and AIC had no right to require they be exchanged for cash), nor were they transferrable without AHL's consent. [Exhibit 421] On March 28, 1985 these shares were divided into 10 series of equal size. Series 1 became retractable if the holder gave notice within 21 days following the first anniversary date of the date on which the shares were issued. Series 2 were similarly retractable on the second anniversary date, and so on through series 10, such that in theory the shares could be fully redeemed in 10 years; [Exhibit 421; Exhibit 328 at 237]

2. Loan receivable from 314986, $2,000,000; and
3. Amounts receivable by virtue of the Agreements for Sale of the real properties, $15,200,000 ($21,040,000 less credit to purchase price of $5,840,000).

According to Exhibit 281 at 4 and 5, FIC and AIC recorded a gain of $2,933,847 on the transaction, composed of gains on the sale of Carma and Nu-West debentures after a write-off of accrued debenture interest against those gains, and net gains on the sale of the real properties. According to Exhibit 389 at 169 and 170, the journal entries included:

	FIC	AIC	TOTAL
Gain on sale of real estate	$1,473,656	$242,932	$1,716,588
Accrued interest on debentures	719,970	163,014	882,984
Gain of sale of debentures	293,037	64,393	357,430
Loss on Venture Properties	(19,987)	(3,170)	(23,157)
Total Gain	$2,466,676	$467,169	$2,933,845

PGL disposed of its holdings of Carma and Nu-West debentures and received or redeemed its own preferred shares, and recorded a gain of $1,199,000. [Exhibit 281 at 4] There is some evidence that PGL initially acquired the debentures from mutual funds managed by PSML. [Exhibit 533 at 80]

AHL issued preferred shares from its treasury, disposed of the PGL preferred shares, and received Allarco, the Bank and the 50% interest in Travellers.

AGL and 314986 disposed of the Bank, Allarco and the 50% interest in Travellers, and received cash, the real properties, the Carma and Nu-West debentures and the Venture Properties Securities. AGL immediately wrote down the assets it received by $16,729,000, and recorded a net loss of $8,606,000. [Exhibit 281 at 5-6]

The Master Sale Agreement dated June 29, 1984 [Exhibit 281, Tab 11] was executed on behalf of FIC and AIC by Marlin and Espenberg, on behalf of PGL by Donald Cormie, and on behalf of AHL by Donald Cormie and Petracca. James Cormie testified that FIC and AIC had the freedom to accept or reject the deal. [14167] Donald Cormie said he agreed with the transaction, but was not called upon to decide whether it should have been undertaken. [22233] Donald Cormie participated in drafting the letter agreement [Exhibit 281, Tab 10] signed by FIC and AGL. [17294] I find that James Cormie, Marlin and Donald Cormie were involved in the negotiations and decided to undertake the transaction.

Prior to committing to the transaction, PGL had no valuations of the assets acquired. Donald Cormie said there were none [17293-4], while James Cormie said Peat, Marwick, Mitchell & Co. did a "quick evaluation" on the subsidiaries, based on "financial statements, et cetera". [14157] I find there were no valuations of the acquired assets prior to undertaking the transaction.

Petracca obtained an opinion from Peat, Marwick, Mitchell & Co. dated September 12, 1984. [Exhibit 281, Tab 15] The opinion stated:

> In considering what Principal Group Limited or one of its related companies might be willing to pay for the outstanding shares of the bank, we believe an offer in the range of $18.5-$19.5

> million (Canadian) might be appropriate. You will appreciate that we are not expressing an opinion on the value of the shares of the Bank, nor have we been engaged to carry out such a valuation, but based on our knowledge of the Bank, our discussions with our office in the Cayman Islands and our experience with clients who have established offshore entities we believe the above noted price range may be appropriate for purposes of your negotiations.

The letter was reissued on October 19, 1984. [Exhibit 281, Tab 14] The corresponding paragraph states:

> In considering what Principal Group Limited or one of its related companies might be willing to pay for the outstanding shares of the bank, we believe an offer in the range of $18.0-$19.5 million (Canadian) might be appropriate.

The Alberta regulators were in possession of both letters. [Exhibit 281, Tab 18]

Petracca also obtained a letter from Deloitte Haskins & Sells dated October 4, 1984 [Exhibit 281, Tab 20] reviewing an opinion (the Weir opinion, Exhibit 281, Tab 19) on the going concern value of the shareholders' equity of Allarco as at September 24, 1984. The Weir opinion valued the company at $15,680,000. Deloitte Haskins & Sells made certain "observations" and concluded that given the high element of subjectivity in the valuation of any oil and gas company, it believed that a range of values could be developed, each member of the range having equal merits, and that if such a range were developed, the valuations attributed to Allarco by both Weir and AHL, being respectively $15,680,000 and $17,250,000, would be accommodated by the range.

The PGL summary of the transaction [Exhibit 281, Tab 2] stated that the original concept centered around three key assets of FIC and AIC and offered the following justifications for the transaction:

1. The Venture Properties mortgages. In addition to the real property security, the mortgagees held personal guarantees from Kuffler who, through his United States company, Venture Properties Inc., owned one key asset located in the State of Colorado in the United States. "Carma" (a member of the Allarco Group, and whether the summary is referring to Carma Ltd. or Carma Developers Ltd. is not known and does not matter) held a 50% interest in that same asset. The mortgage with its guarantor was worth more to Carma than it was to the Principal Group.
2. The Carma debentures. Carma Developers Ltd. had proposed a debt reorganization plan. The reorganization plan was passed by its debenture holders in spite of the opposition of the Principal Group; however, by repurchasing its own debentures, Carma was able to eliminate that liability from its balance sheet.
3. Nu-West debentures. Nu-West Group Ltd., affiliated with Carma [14144], was also planning a debt reorganization [announced March 22, 1984: Exhibit 281, Tab 27], which required approval by vote of its debenture holders. The Principal Group's position combined with that of another large debenture holder was capable of "virtually killing" the plan of reorganization. Carma was a 42%-owned affiliate of Nu-West.

In addition, according to the summary, Carma wished to dispose of the subsidiaries at the insistence of its bankers. In order to balance the transaction to the value of the subsidiaries, about $38,000,000, and because Carma wished to manage more real estate holdings, the Principal Group added $23,000,000 worth of properties to the deal.

The Agreements for Sale were with limited recourse to the property. [Exhibit 281, Master Sale Agreement, section 15] The Master Sale Agreement provided that notwithstanding the provisions contained in any of the Agreements for Sale, if the gross income earned each month was applied by the purchaser first to pay operating expenses and, secondly toward payments due under the Agreement for Sale, and if the buyer certified such compliance and the amount of gross income and operating expenses, then the minimum payment the purchaser would be required to make would not exceed the greater of the payment due under the Agreement for Sale and an amount equal to the net income (gross income less operating expenses) of each parcel. However, if the net income payment was less than the amount due under the Agreement for Sale, then the difference would be added to the principal balance then outstanding under the applicable Agreement for Sale. So long as 314986 paid the net income earned on the properties, no matter how small, default for non-payment of interest could not occur.

By virtue of the *ICA*, FIC and AIC could not directly acquire the shares of the Bank and of Allarco, and 50% of the shares of Travellers. A "legal for life" company (a reference to that type of company, the shares of which are qualified investments for life insurance companies to which Part 3 of the *CBICA* is applicable) was required and AHL was such a company. A legal opinion was obtained from Parlee, Irving, Henning, Mustard & Rodney, dated June 28, 1984 [Exhibit 389 at 73], that the preferred shares of AHL constituted a qualified asset pursuant to the *ICA*. Therefore, AIC and FIC acquired the AHL preferred shares and AHL acquired the hard assets from AGL. AHL, which had been inactive for some years, was solely owned by CSL and this fact later assumes some significance. Management's position, particularly that of Donald Cormie, was that AHL simply facilitated the transaction for the benefit of FIC and AIC. [17280-92; 17270-3]

Principal Group witnesses testified that notwithstanding FIC and AIC paid $15,200,000 cash on the transaction, the companies received greater cash flow on the AHL preferred shares because the assets transferred to AGL and 314986 were essentially non-performing. [Donald Cormie, 18843-4, 22230; Marlin, 11981-3, 12962; James Cormie, 14979; Johnson, 6923-25; 7530-31] Johnson's comment was restricted to the assets given up for the AHL preferred shares (the Venture Properties Securities, Carma and Nu-West Debentures and cash) and excluded the real estate sold by FIC and AIC to 314986. [6928] There was also evidence that the earnings on the AHL preferred shares approximated the earnings that would have been booked on a consolidation basis had the subsidiaries (Allarco, the Bank and Travellers) been acquired directly by FIC and AIC. [Johnson, 6926] James Cormie said the earnings in the new subsidiaries of AHL were not earning sufficient at the outset to fully cover the dividend payable on the preferred shares. [14166] There was also evidence that the assets ultimately acquired by AHL were more valuable than the assets disposed of to AGL and 314986. [James Cormie, 14979]

Management took the position that the transaction allowed FIC and AIC to place the real properties in the hands of experienced developers. For example:

> . . . But we found that Carma was having pressure from its bank . . . to sell off a number of its businesses and to concentrate on the business that it had the expertise in, which was land development and development generally.
>
> . . . . .
>
> So it seemed a logical solution for First Investors to find a way that it could pass to Carma a number of properties that Carma could manage and do something with that First Investors or Principal Group, for that matter, didn't have the staff or know-how or the experience to handle, and to take something from Carma that would be of equivalent value. So it was proposed — the transaction was proposed in that general light.
>
> Then they came back and said that they had to have some cash, and that was when the $15.2 million got introduced, which was supposed to be a mortgage loan on the properties they had acquired, but ended up as a form of an Agreement for Sale secured on the properties. [Donald Cormie, 17263; see also James Cormie at 14980; Exhibit 281, Tabs 1 and 2]

The chronology of events and circumstances surrounding this transaction is:

1. The Superintendent of Insurance by letter dated January 12, 1984 and addressed to FIC (attention of Marlin) [Exhibit 281] expressed concerns related *inter alia* to the deterioration of the mortgage portfolio of FIC and AIC;

2. The Superintendent had also become concerned with the value of the Carma and Nu-West debentures. With his letter dated January 12, 1984 the Superintendent enclosed some calculations made pursuant to s.8 of the *ICA*, which valued Carma, Daon and Nu-West debentures as a total loss. FIC had already written $1,200,000 off the carrying value of Nu-West debentures but was not prepared to do so on the others. A meeting was subsequently held with the Superintendent, wherein FIC presented an information package dated January 25, 1984 [Exhibit 281, Tab 23] dealing with the suggestion that unimpaired capital be reduced by $4.2 million owing to write-off of the debentures. FIC claimed that Nu-West debentures were valued at market, said to be 47.5¢ on the dollar. The company valued Carma and Daon debentures, however, at cost on the reasoning that since both companies were in the process of implementing reorganization plans approved by the debenture holders, their debentures were not in default. Notwithstanding this, Principal Group considered the market value of the Carma debentures to be a maximum of 42.5¢ on the dollar and valued them around 35¢ on the dollar for the books of the mutual funds. [Exhibit 281, Tabs 23 and 25]
3. The FIC and AIC audited Financial Statements were issued on or about May 7, 1984. As noted elsewhere they included a contingency note concerning loss in value of the security underlying certain mortgages, and raised going concern considerations. Donald Cormie called the auditors to register his displeasure with the notes;
4. The declaration of additional credits on certain term certificates issued by FIC and AIC had been suspended and therefore not accrued as liabilities on May 8, 1984 owing to the results of operations shown in the audited financial statements. As noted elsewhere, Marlin and Donald Cormie took the position during this time that additional credits were discretionary and need not be declared. They were ultimately re-instated as a result of this transaction; [13497; 13499]
5. By letter dated May 11, 1984 [Exhibit 281, Tab 31], the Superintendent ordered that $72,000,000 in capital be injected into FIC and AIC , but stated that he would accept an immediate interim capital injection into FIC and AIC of $35,000,000 if the companies disagreed with his assessment. He also made other demands. The letter noted that the Superintendent's concern regarding valuation of Carma, Nu-West and Daon debentures remained unsatisfied. Marlin acknowledged that this dispute over valuation of the debentures was a motivating factor of the transaction. [11970, 12970-1]
6. During the second week of June, 1984 the consolidation working papers of PGL were ready for the auditors to review. Touche Ross & Co. were asked by company officers (the evidence does not disclose their identity) what impact this transaction might have on the consolidated financial statements, and expressed the hope that such a consummated transaction would have a positive impact on the draft contingency note to the PGL consolidated financial statements which the auditors were proposing; [Exhibit 527 at 23]
7. By letter dated July 5, 1984 Marlin advised the Superintendent that the Carma and Nu-West debentures and certain properties had been sold, at book value, in an arm's length transaction. Transaction #3 was held out to the Alberta regulators as solving problems of FIC. [11446, 11452, 11456]
8. Documentation supporting the value of the major assets acquired was prepared subsequent to the transaction date.

When the Principal Group committed to the deal on June 12, 1984 it had no legal opinion supporting the legality of the acquisition by FIC and AIC of AHL preferred shares. Marlin testified [11984-87] that he understood at the time he committed FIC and AIC to the transaction on June 12, 1984 that it was anticipated that a favourable legal opinion was forthcoming. It was confirmed to Marlin at the closing, which took place in the offices of Parlee, Irving, Henning, Mustard and Rodney that the AHL preferred shares were legal investments. A legal opinion was obtained, as noted earlier, to the effect that the AHL preferred shares were qualified investments for investment contract companies.

Schenkelberg, a chartered accountant with experience in business valuation who has familiarity with the matter owing to his position with Collins Barrow Limited, estimated the value of the assets acquired by AHL to total $28,690,000. He estimated the value of the assets given up at $21,300,000, and concluded, on the assumption that AHL is a subsidiary of FIC and AIC, that FIC and AIC gained approximately $7,870,000 on the transaction. Schenkelberg considered, for the purposes of his analysis, AHL to be a wholly owned subsidiary of FIC and AIC. In fact, the common shares of AHL were owned by CSL, the president of AHL was Donald Cormie, and FIC and AIC had no control over AHL. [Exhibit 611]

Marlin saw the benefits of the transaction to FIC and AIC to be the realization by FIC and AIC of the face value of the Carma and Nu-West debentures and the Venture Property Securities. [11975-6] In so doing, gains were booked [11978], a benefit to this extent:

> I suppose if you look at it long term, you don't really know whether the profits you've booked is really going to be a profit until you dispose of everything. But the transaction books the profit accounting-wise, in any case. [11979]

Donald Cormie agreed that one of the reasons for the transaction "could" have been to avoid or eliminate write downs and reserves. [22231-3] I find that it was and Donald Cormie both knew it and desired the same.

Exhibit 281 indicates that the value of the assets given up was approximately $18,293,500. It is reasonable to accept that the value of the assets given up fell within a range of approximately $18,300,000 to $21,300,000. It is also reasonable to conclude that the value of the assets received was in the range of about $29,000,000. On the surface, therefore, the transaction appears to have been reasonable for the Principal Group as a whole. This proposition must be examined.

Had AHL and its parent CSL not dissipated some of the assets acquired as a result of this transaction (see Transaction #8, *infra*) then on eventual redemption of the AHL preferred shares, without regard to the time value of money and assuming the value of the acquired assets does not erode over the long period of time required to fully redeem the AHL preferred shares, FIC and AIC might have benefitted through realization of additional value. As Marlin said, however, owing to the long time frame, one does not know whether the profit will be realized. While the value of the acquired assets as of June, 1984 is known, their value over the time period required to fully redeem the AHL preferred shares is not. The benefit is, therefore, speculative from the point of view of FIC and AIC.

Moreover, in the interim, FIC and AIC suffered a liquidity loss and a loss in earning power on $17,200,000. The Agreements for Sale provided for: payments of interest only, at 6% per annum, for the period June 29, 1984 to June 28, 1985; blended payments of principal and interest, with interest calculated at 10% per annum, for the period June 29, 1985 to June 28, 1986; and blended payment of principal and interest, with interest calculated at 14% per annum, for the period June 29, 1986 to June 28, 1987. On June 28, 1987, the balance became due. The $2,000,000 loan to 314986 bore interest at 14.3% per annum from June 29, 1984 to June 29, 1986, whereupon the principal became due. Howver, FIC and AIC advanced the funds to 314986 to pay the interest. FIC and AIC also earned a return on the dividends from the AHL preferred shares. Those dividends, expressed as a percentage of the $17,200,000 outstanding, amounted to an additional annual return of approximately 8.47%. Over the three years during which the loans to 314986 were outstanding, therefore, the overall theoretical return is comparable to the 18.8% average return which Donald Cormie said FIC and AIC could have earned on monies otherwise invested. [17288]

The imprudent aspect of this transaction lies in advancing the additional funds. $15,200,000 was secured on real property with a book value of approximately $21,000,000 a ratio of 70.4%. On the loan secured by the Venture Properties Securities the ratio was about 25%. However, as the evidence shows, the book values of these properties were supported by assets valued with reference to some economic recovery in the real estate market. They were not current market values. For example, as noted above, the Venture land was appraised at $2,600,000. On the basis of third party opinions of market values [Exhibit 281], the amount of cash lent exceeded the value of the security. It is perhaps one thing to value foreclosed property on the basis of economic recovery. It is quite another to make a fresh loan to a new borrower, 314986, involving the payment of more funds to that new borrower's parent on such value. The loan agreements also were limited in recourse to the security. In fact, as noted above, as long as gross revenue from each property was applied to expenses and any balance remitted to FIC or AIC, as the case may be, there could not, under the terms of the Master Sale Agreement, ever be a default for non-payment of interest until maturity.

This amounted, the evidence tends to show, to imprudent lending and exposed FIC and AIC to a high risk of default and consequent additional loss of funds and earning power. During testimony Marlin recognized that risk when he stated that even if the properties came back on the books, we still had a "hell of a deal". [11982] It might be true that the deficiency would be compensated by other gains within the entire series of transactions. However, that additional value was locked within AHL (the preferred shares with limited redemption features), whether it was ultimately realizable was a matter of speculation, and in the event of default on the real property agreements, having regard to the dividend rate on the AHL preferred shares, the return to FIC and AIC would be dramatically reduced.

In fact, default occurred. Johnson testified that as soon as the $500,000 sinking fund was exhausted on the $2,000,000 loan to 314986, that loan went into default. [6418] The Agreements for Sale in respect of the real properties also went into default, and those properties were as of December, 1987 in the process of being returned to the receiver and manager of FIC and AIC. [6415-7]

Moreover, the return on the Agreements for Sale was minimal since the day they were made. According to the 1984 Annual Examinations [Exhibits 550 and 551] prepared by government auditors, FIC and AIC had received no interest (principal payments did not commence until July, 1985) on the Agreements for Sale for the year 1984. According to the report, FIC and AIC were accruing and then reserving 100% of the interest due on a monthly basis. The government auditors reported that during 1985 the total balance on the Agreements for Sale had increased by $1,100,000 and that payment of $648,745 had been received on them during the year. Had the payments been made as agreed the loan balances could not increase. It is likely, therefore, that the amounts received were a payment of net income earned on the properties pursuant to the Master Sale Agreement as earlier described.

The 1985 audit working paper in relation to the Agreements for Sale stated:

> — there is considerable uncertainty as to whether Carma will ever make the payments on the AFS [Agreement for Sale] — as they are currently in financial difficulties. However, if the value of the property exceeds the AFS, it would make sense for Carma to sell the properties to realize the gain. For this reason, we have to assume that Carma will make the payments on the AFS — so it is reasonable for FIC/AIC to accrue the interest, so long as the resulting carrying value is supported by the value of the underlying security. Furthermore, Carma have been doing work on the properties — including negotiating leases,

> putting in decent property management firms, etc. etc. Carma have not had to put up any cash — repairs and so on are paid for out of the cash flows. [Exhibit 538 at 176]

In 1986, the auditors noted that their 1985 comments were no longer true as they understood that virtually all of the properties were "coming back" to FIC and AIC. Indeed, one property (Princess Apartments) was returned to the owned property account on December 12, 1986. The auditors noted in their 1986 working papers:

> The mortgagor is actually a numbered company set up by Carma. We are unable to secure statements for this numbered company in order to determine their ability to pay the mortgage. To date, no payments have been required under the Agreements for Sale — either interest or principal. At least if amounts were due we would have been in a position to see whether Carma were making payments. This would have been a big help in determining collectibility. [Exhibit 538 at 175]

The audit working papers [Exhibit 541 at 4-11] do note that in 1986 some payments were received in respect of certain of the properties. According to those working papers, none of the payments received during the year 1986 covered the interest due on the Agreements for Sale, nor even the property taxes and other payments, such as insurance and amounts due to first mortgagees, being made by FIC and AIC. For the year ended December 31, 1986 the payments received were less than payments made. FIC and AIC lost $163,880 over the year 1986 on those properties; that is, their return on investment was negative.

I find that no, or at best minimal, payments of principal and interest were received on the Agreements for Sale; certainly nothing more than minimal payments were made. The $2,000,000 loan yielded nothing because the interest payments were funded through the loan advance, and secured on over-valued property. Therefore, the return on Transaction #3 was about 8.5% (the return on the AHL dividends as a percentage of cash advanced), before accounting for the continuing cash losses on the real properties. Such return also does not consider the loss owing to the insertion of PGL preferred shares within AHL (Transaction #2, *infra*).

The result of this aspect of the transaction is that FIC and AIC have obtained an external property management function in consideration of their investment by way of loan in the amount of $17,200,000 limited in recourse to over-valued security, to a numbered company subsidiary (created for the purpose of doing the transaction) of a financially ailing corporation, namely Carma Developers Ltd. (which received $15,200,000 of the loan). In effect, 314986 put up no money to service the Agreements for Sale and was simply acting as a property management company. [6439] The capital expenditures (taxes and so forth) were being made by FIC and AIC. In doing so, management put FIC and AIC at extreme risk, if not guaranteed loss. Not only was the security inadequate, but also it is incredible to suggest that that debtor's covenant was of any value where the debtor was a newly-formed numbered company and a wholly-owned subsidiary of a corporation in default on its debentures and in the process of reorganizing itself pursuant to the *CCAA*. That the risk materialized is no surprise.

The letter agreement which Donald Cormie helped to draft and Marlin executed stated with respect to the purchase of the real properties:

> It is recognized that Allarco is operating under specific restraints with respect to contribution of cash expenditures and Allarco is unable to make any expenditures other than those expenditures covered by operating cash flow from the properties.

A memorandum authored by Nicholson (comptroller of PGL), addressed to James Cormie and Patrick and dated September 6, 1984 only reinforces the existence of this very fundamental feature of the transaction:

> The results of Robert Day, Lester Goodkey, and myself meeting with Allarco personnel are summarized below:
>
> 1. Allarco says none of the properties will generate a positive profit, let alone a profit of 6%. For example, the projected net profit on the Princess Apartments is a $114,000 loss; for the Dunedin Building a $20,000 loss WITHOUT the first mortgage charge; for the Simon Valley Mall a $8,000 loss. This takes no account of basic operating improvements.
>
> 2. Allarco says its understanding of the agreement is that PGL will:
>
> — absorb and fund operating losses
>
> — fund improvements.
>
> - When it was mentioned that we did not see any such clause in the agreement, Allarco indicated that it was in PGL's interest to fund losses and improvements because "it would only be getting the properties back at the end of the three years anyway." Allarco further indicated that it was doing PGL a favor by taking on the property management. We pointed out that the contract did have benefits to both sides, and that Allarco was involved because of its expertise in property management, and should therefore be expected to perform.
>
> 3. Having commented on Allarco's expertise in property management, we were informed that Allarco is continuing to use the Property Managers which we used on all of the properties, and has plans to do so for some time in the future. [Exhibit 524 at 164]

In light of such evidence, it is difficult to accept Donald Cormie's proposition that Carma could be expected to develop these properties [18836-41] and indeed, Carma did nothing with the properties. [18841]

Touche Ross & Co. concluded in respect of this transaction as follows:

> We concluded on July 27, 1984 that, in our judgment, the transaction did not decrease the Group's exposure to loss resulting from the mortgage and owned property portfolios, and we delivered two draft notes we felt required insertion into the notes of the [PGL] consolidated statements . . . . [Exhibit 447 at 209]

As noted, the lack of return might be made up over the long run (if FIC and AIC could survive so long) from the possible increased value of the assets placed in AHL so long as that value was maintained. FIC and AIC did not last long enough to benefit in this way.

FIC and AIC suffered as follows:

1. Loss of liquidity and earning power on $17,200,000 cash;
2. Retention of risk on the real properties that were simply freshened up with a new shell company borrower; and
3. Increase in negative interest spread.

I find that the transaction was designed to cover up the serious problems in the FIC and AIC mortgage and owned property portfolio (and indeed that of PS&T when considered with Transaction #1). The transaction was conceived, developed and executed by Donald Cormie, James Cormie and Marlin. The transaction is also evidence tending to show, on the part of Donald Cormie, James Cormie and Marlin, conduct which is unfairly prejudicial to and in disregard of the interests of, the investment contract holders. FIC and AIC were simply throwing away good cash in exchange for financial fantasy and these men knew it.

TRANSACTION #2

The $36,340,000 AHL preferred shares issued to FIC and AIC in the course of Transaction #3 carried a dividend rate of 4% per annum, with a participation feature. The assets acquired (namely, the Bank, Allarco and Travellers) did not yield sufficient cash flow to support payment of the 4%

dividends ($1,453,600). On December 17, 1984 AHL purchased PGL preferred shares with a face value of $12,500,000 for the same amount of cash which carried a dividend rate of 11.6% (a yield of $1,450,000). The dividend rate on the PGL preferred shares was chosen to yield the same amount as the dividend payable on the AHL preferred shares to FIC and AIC. [Exhibit 333; 7663-4; 14185-6]

In order to carry out the transaction, PGL lent $12,500,000 cash to CSL, interest free. CSL then lent that cash to AHL at an interest rate of 12¾% per annum. [7662; Exhibit 426 at 136] Pearce testified [7662] that the 12¾% interest on the loan was accrued. James Cormie and Donald Cormie testified [15125-6; 15131; 20448] that interest was paid on the loan. AHL paid the cash back to PGL in payment of the purchase price of the PGL preferred shares. While PGL's receivable from CSL did not bear interest, PGL became obliged to pay dividends to AHL on the 11.6% preferred shares. [14978-15134; 17299-314]

Marlin testified [12076; 12961] that the purpose of the transaction was twofold: first, to increase the capitalization of PGL; and secondly, to provide a source of income to AHL to assure that AHL could pay the dividends on the 4% AHL preferred shares held by FIC and AIC. As noted elsewhere, PGL recorded this capital on its balance sheet without disclosure of the facts that a related party had acquired the shares, with funds provided by PGL. That balance sheet was published in the 1984 Annual Report as part of the audited consolidated financial statements of PGL.

Donald Cormie testified that the purpose was to guarantee AHL's dividend payment to FIC and AIC, in response to concern expressed by the regulators that the dividends due on the AHL preferred shares might not be secure. He testified that this series of PGL 11.6% preferred shares was created for the purposes of the transaction, that the transaction was considered to be for the benefit of the investment contract companies by the PGL Board, and that PGL issued shares because it would not as a corporation guarantee the payment of the dividends. PGL's policy was not to give guarantees. [17229-314]

Management had taken the position that AHL participated in Transaction #3 to assist the investment contract companies. It happened to be a "legal for life" company available for use in Transaction #3, the shares of which were employed as a vehicle to enable FIC and AIC to acquire an interest in the hard assets acquired from AGL in that transaction. Yet, through this transaction, AHL increased its assets and liabilities by $12,500,000, and the debt owing by AHL to CSL now ranked in priority to the preferred shares owned by FIC and AIC. There is no justification for any company acquiring an interest paramount to FIC and AIC in those assets (while PGL contributed some Carma and Nu West Debentures to Transaction #3, it was paid through the redemption of its own second preferred shares previously held by AHL). The money necessary to fund the purchase of the PGL preferred shares could have been invested by CSL in equity or debt subordinate to the rights and privileges attached to the preferred shares held by FIC and AIC.

It is difficult to see the benefit of this transaction to AHL. The loan from CSL to AHL carried interest at 12.75%, while the dividend paid to AHL on the PGL preferred shares was 11.6%. Moreover, the acquisition of preferred shares in PGL (which the evidence tends to show was by this time insolvent) could hardly have been seen as an attractive investment. It is quite clear that AHL was nothing but a captive buyer. PGL preferred shares were in no way worth their face value, and yet AHL had now become indebted to CSL for $12,500,000 (with interest thereon at a rate exceeding the return on the PGL preferred shares) to acquire them. This transaction is the responsibility of the Board of PGL and of the President of AHL, Donald Cormie.

The evidence tends to show that Donald Cormie, James Cormie and Marlin indirectly prejudiced unfairly the interests of the investment contract holders. Further, the evidence tends to show, Donald Cormie exercised the powers of the directors of AHL in a fashion which unfairly prejudiced and disregarded the interests of security holders of AHL, namely FIC and AIC.

TRANSACTION #4

FIC and AIC had lent money to a company called Rocky Mountain Breweries Ltd. ("Rocky Mountain"), a brewer of beer in Red Deer, Alberta. The loan was advanced in early 1982 and the proceeds were used in large part to pay out another lender. [Exhibit 516 at 163] As security for the loan, FIC and AIC took a debenture charging all assets of the borrower, and a mortgage registered against real property. FIC and AIC also held a mortgage registered against real property as security for a separate loan to Wexford Developments Ltd., a corporation related to Rocky Mountain. [14200] These loans were part of the group of high risk mortgage loans made in the early 1980s as described in the section of this Report on investment strategies. Both loans were in default at December 21, 1984, and the total amount outstanding was approximately $9,000,000. [Exhibit 334]

Pinch Penny Investments Ltd. ("Pinch Penny"), an unrelated company established as part of the estate planning of the original owner of the brewery (Ben Ginter), held second and third mortgages over certain of Rocky Mountain's real property. In order to acquire control over the brewery, FIC and AIC acquired these mortgages on April 30, 1984. In consideration, FIC and AIC traded owned properties (called Spectrum and Eckstrand) to Pinch Penny. The owned property trade was recorded by FIC and AIC at book value of approximately $4,500,000 although the appraised value of the Spectrum and Eckstrand properties was about $152,000. [Exhibit 334]

The acquisition of the Pinch Penny mortgages has an additional facet. The executor of the Ginter estate had agreed to trade the second and third mortgages in return for the Spectrum and Eckstrand owned properties. However, one of the beneficiaries of the estate wanted immediate cash and a form of undertaking that the Spectrum and Eckstrand owned properties were worth about $600,000. As the deal was already closed, Donald Cormie caused Wyocan Resources Ltd. ("Wyocan") to undertake to pay the estate $600,000 on demand. Upon such demand, the estate would convey the Spectrum and Eckstrand owned properties to Wyocan in exchange for the $600,000. The estate took the cash instead of the properties; Wyocan paid the cash and took the properties.

The Spectrum and Eckstrand properties were described by Donald Cormie as a piece of land in Canmore, Alberta on the side of a mountain, and a subdivision in Olds, Alberta. They were not valuable (appraised at about $152,000); Donald Cormie admitted they were valueless. [17321] On April 30, 1984 $600,000 which PGL had borrowed through the sale of promissory notes was lent to CSL, which passed it on to CIL, which loaned it to Donald Cormie, who loaned it to EL&F, through which it was passed on to an Edmonton law firm in order that Wyocan could buy the mountainside and the subdivision. The entry was subsequently revised to go through Cormie Ranch, and it remained on the books as due from Cormie Ranch. This money was borrowed from the public at 9.925% per annum, was lent to CSL at 10.05% per annum, and then to CIL at 10.175% per annum. Donald Cormie borrowed it from CIL at 10.3% per annum. [Exhibit 337 at 2; 7854-5; 21620-1] Wyocan had no other assets. [17321]

A receiver and manager was appointed by the Court of Queen's Bench of Alberta, on the application of FIC and AIC, over the assets and undertaking of Rocky Mountain. The assets were sold pursuant to Court Order on January 31, 1985 to 318939 Alberta Ltd. ("318939"), a corporation all of whose shares were owned by FIC and AIC, and which was incorporated on October 4, 1984. The purchase price was to be $10,101,000, although FIC, AIC and 318939 recorded the transaction on their books based on the book value of the loans ($9,348,012) plus the cost of receivership and other items ($1,667,964). The entire purchase was funded by FIC and AIC. In addition, the owned property which formerly was security for the loan to Wexford Developments Ltd., and by this time acquired through foreclosure proceedings by FIC and AIC, was sold to 318939 at book value of $3,518,424. In the result, FIC and AIC recorded a total loan due from 314939 in the amount of $14,534,400.

Control of the brewery having been acquired, the FIC, AIC and PGL directors assigned employees of PGL and CSL to run the brewery. [14199-200] The brewery was intensively managed and turned a profit of approximately $1,000,000 in each of 1985 and 1986. [8274; 17332] On February 1, 1985 PGL purchased the common shares of 318939 for $100 from FIC and AIC, and on February 5, 1985, 318939 changed its name to Rocky Mountain Brewing Corporation ("RMBC").

On March 28, 1985 PGL purchased 14,040,000 Series 11 through 15 preferred shares of AHL from AHL's treasury. The AHL shares carried a 6% dividend rate, which was determined by Donald Cormie, and were created pursuant to a directors' resolution dated March 28, 1985 and signed by Donald Cormie and Petracca. [Exhibit 334; 17324] These shares series had no retraction feature. On June 14, 1985 retractability was added. Series 11 became retractable on the third anniversary after their issue, Series 12 on the fourth anniversary, and so on through to Series 15 which was retractable on the seventh anniversary after their issue. [Exhibits 334, and 328 at 260]

The consideration for the AHL preferred shares was 5 promissory notes, each with a face value of $2,808,000 for a total of $14,040,000 each payable 180 days after demand and bearing interest at prime less 2.5% per annum.

On the same day, March 28, 1985, PGL sold the Series 11 through 15 shares, plus 360,000 of Series 1 through 10 AHL preferred shares (acquired in Transaction #3) to RMBC. PGL now held a loan receivable from RMBC in the amount of $14,440,000 (the unpaid portion of which was subsequently converted to RMBC preferred shares and a debenture in October, 1985), and owed RMBC $40,000 on an inter-company account.

On that same day, RMBC transferred all the preferred shares and the $40,000 intercompany debt due from PGL to FIC and AIC in payment of its debt to those companies, arising upon the sale of the brewery and the Wexford properties. After recording a loss on the transaction of $94,402, FIC and AIC now held AHL preferred shares in the amount of $14,400,000 and a small receivable from PGL.

On December 1, 1985, PGL sold its RMBC common and preferred shares and the RMBC debenture to Matrix. Matrix issued 44,500,000 common shares in payment, at 30¢ per share, for a total of $13,350,000. Prior to this transaction, Matrix (the shares of which were listed and traded on the ASE) was controlled by Allarco.

When the transactions were completed, FIC and AIC disposed of the Wexford and Rocky Mountain loans, and the Spectrum and Eckstrand owned properties. They reduced their intercompany account balance with PGL ($40,100), and acquired AHL preferred shares in the amount of $14,400,000. FIC and AIC recorded a loss of $404,138 on the transaction (primarily due to the write-off of a receivable that was set up to represent the difference between the book value of the owned properties transferred to Pinch Penny and the book value of the second and third mortgages acquired from Pinch Penny).

PGL became indebted to AHL in the amount of $14,040,000, and acquired $13,350,000 of Matrix shares (there were various other adjustments and intercompany balances, not material to this discussion, which are not set out herein). PGL recorded no gain or loss as a consequence of this series of transactions.

AHL received a promissory note from PGL and issued more preferred shares. It recorded no gain or loss.

Matrix acquired the common and preferred shares of RMBC, and the RMBC debenture plus accrued interest. It issued 44,500,000 shares at 30¢ each. It also recorded no gain or loss.

The Receiver of the brewery estimated the brewery to have a liquidation value as of December, 1984 of $3,200,000, and a going concern value of approximately $6,000,000. An appraisal prepared in December, 1984 concluded that the probable market value of the brewery was approximately $5,800,000. The Receiver of the brewery received an offer on the brewery from one J.C. Green in the amount of $13,200,000. No deposit was received, banking references were not forthcoming, and there was no evidence of any substantial financial backing. [8267] The appraised non-distress market value of the Wexford property was $1,280,000. The Spectrum and Eckstrand properties (transferred to Pinch Penny) were appraised at approximately $152,000. [Exhibit 334]

The auditors accepted that the fair market value of RMBC as at December 2, 1985 was reasonably estimated at $13,350,000. A Deloitte Haskins & Sells chartered business valuator considered this matter. His ultimate rationale for accepting that value was: "this is the price agreed to by Matrix Exploration Ltd. in its negotiations with Principal Group Ltd. This is based on the premise that, as you [McCutchen] indicated, the Board of Directors of Matrix are largely external to the Principal Group organization, and therefore the price effectively reflects an arms length transaction." [Exhibit 539]

In fact, only three of the eight directors of Matrix were "outside directors" and one of them was a director and officer of Allarco. [Exhibit 539 at 39-40] McCutchen testified that he told the business valuators that the Audit Committee of the Matrix board was largely external to Principal Group, and that his understanding was that the Audit Committee were the persons within Matrix who were assessing the reasonableness of the transaction. [24693-9]

Pearce testified that the RMBC shares were initially sold to PGL because the *Liquor Control Act*, R.S.A. 1980, c. L-17 or regulations thereunder prohibit a financial institution from owning an interest in a brewery. In fact, s.79 of that Act prohibits a brewer from having a financial interest in a vendor selling liquor, including a hotel. Even after the transfer to PGL, the concern of the Liquor Control Board was not completely eliminated. [7676] Thus, FIC and AIC acquired AHL shares, and Matrix acquired the brewery.

Pearce also testified that the amounts for which 318939 acquired the brewery would ultimately have to be approved by Donald Cormie. [7685] He said the Matrix shares were valued at the trade weighted average price of Matrix shares trading on the ASE for three months leading up to the date of the transaction. [7688]

As noted above, the AHL preferred shares carried a dividend rate of 6%. Marlin testified that the return on those shares was better than what FIC and AIC were receiving on the assets that they held prior to the transaction. [12103; 12973] He also testified that through the use of the AHL preferred shares, FIC and AIC were able to avoid taking a large write-down on the original mortgages and properties and were thereby able to avoid the consequent capital deficiency. The regulators never suggested that the transaction be unwound. [12972-76]

James Cormie testified that PGL was a "parking place" for the brewery until management could figure out what to do with it. "We" (I take that to mean the board of directors of PGL) later decided that the best place for it was in a public company, so the brewery was traded in its entirety at net book value in return for Matrix shares. [14204] James Cormie also testified [14199; 14982-3] that a write-down of the assets of FIC and AIC would be avoided by doing this transaction, that it enhanced the value by maintaining the brewery as an operating entity, and that the AHL preferred shares were better assets than those which FIC and AIC gave up.

Donald Cormie testified [17326-7] that the value of RMBC could not be realized in the short term. By transferring the brewery to Matrix, the shares of which were attractive to investors seeking a speculative long-term investment, the return over the time horizon would be much higher. This type of investment, he said, was not consistent with the objectives of FIC and AIC, which wanted security in the "relatively short term". So they acquired AHL shares.

Donald Cormie also testified that FIC and AIC were able, through this transaction, to avoid "very substantial" write downs in respect of the Wexford owned property, the brewery, and the Spectrum and Eckstrand owned properties. His evidence was that the loss avoided was approximately $5,000,000. [17330; 18847-51] Donald Cormie testified that he assisted in the negotiations of this transaction and kept Marlin informed. [17333-4] Green was involved as well. [17333-4]

Accepting that FIC and AIC could not own a brewery owing to their involvement in hotels, it was not necessary that in the process of curing that problem the value of the transaction be increased by millions of dollars. It was a complete fiction that the value of these assets could increase so substantially (more than $6,000,000) by swapping them for Matrix shares. FIC and AIC received AHL shares backed by promissory notes issued by PGL, by this time, so the evidence tends to show, their insolvent parent corporation. Nothing significant was acquired from outside Principal Group. Assets were moved about from company to company, and some outside second and third mortgagees whose loans were in default got $600,000 cash courtesy of PGL noteholders.

The evidence tends to show that the whole purpose of this series of transactions was to relieve FIC and AIC from having to write down these assets by approximately $5,000,000. Like Transaction #3, losses were avoided by substituting other related-company shares and debt for assets, whereby any "soft" value in assets held by FIC and AIC could be ignored by transferring those assets out and obtaining in exchange, through circuitous transactions, shares of other companies. Such soft value could be offset by better value assets in the other corporation, with no consequent write-down of its shares. All of this is perfectly consistent with Donald Cormie's often expressed complaint that GAAP requires the recognition of losses when incurred, while denying recognition of gains until the assets are sold. AHL shares were one of the means to circumvent the problem.

I find that Donald Cormie authorized this transaction as president of PGL and AHL and effective directing mind of FIC and AIC. The transaction is, the evidence tends to show, another example of the lengths to which Donald Cormie was prepared to go to avoid recognizing real and substantial losses.

TRANSACTION #6

Effective September 1, 1985, Allarco sold its interest in certain oil and gas properties to Matrix. Allarco received 14,358,000 common shares of Matrix at 30¢ per share, and assumed a bank loan relating to the transferred assets in the amount of $800,000. The total consideration was, therefore, $5,107,400. The transaction was completed at fair market value, using internal as well as outside evaluations. [Donald Cormie, 18866; James Cormie, 14985-6] Pearce confirmed that an updated external valuation was carried out which supported the transfer values. [7699] Allarco retained two gas plants and related producing fields, operated as joint ventures with two other parties.

Donald Cormie said that the transaction was designed to develop Matrix into a major or active public corporation. [17407; 18866] Donald Cormie also testified that the business transferred to Matrix was a semi-speculative, longer term business that should not be "sitting in a private company associated with regulated-type business". [17411] Pearce was told by Donald Cormie that Matrix, an existing public company with no significant operating assets, needed some operations to enable it, if required, to raise capital in the public markets. [7692-3]

Prior to this transaction Matrix had no significant assets, cash flow or earnings. James Cormie said that by placing assets in it, then in the event of a significant oil and gas find, Matrix could raise capital in the public markets. [14220-3; 14985]

At the time, Donald Cormie was a director of Allarco, Matrix and AHL. [17407] Donald Cormie approved the transaction. [17411]

The transaction is described here to demonstrate the nature of Matrix, and the evolution of its share structure. As will be seen below, there is evidence tending to show that Matrix shares became a form of currency within Principal Group.

TRANSACTION #7

As described in Chapter VII, FIC and AIC paid monthly charges to PGL termed administrative levies and interest on subordinated notes. In 1983, FIC and AIC were not charged the administrative levies and subordinated note interest for five months. [6506] The charges were paid for all months of 1984 and 1985. These charges had been paid in cash except for the sum of $2,191,000, which had been paid by FIC and AIC in AHL preferred shares in 1984. [Exhibit 409 at 818-9; 35951-2] The AHL preferred shares did not stay long in PGL. $2,000,000 of the shares went back to AIC in March, 1985 as a "capital injection" in return for a subordinated note. [Exhibit 409 at 819]

The charges which had been paid in cash in 1984 and 1985 were subsequently reversed. As a result, PGL considered itself indebted to FIC and AIC at the end of 1985 in the amount of $10,790,000.

AHL agreed to assume the indebtedness of PGL and also issued a promissory note in favour of PGL for a small sum. In consideration, PGL transferred to AHL 19,618,181 Matrix common shares at 50¢ each (some of the shares created in Transaction #4), and eliminated an intercompany account owed by AHL to PGL in the amount of $1,124,085 (which arose on the sale of PNI shares to AHL: Transaction #9).

In satisfaction of the debt it had assumed, AHL transferred the Matrix common shares at 55¢ each to FIC and AIC. [Exhibit 283]

AHL recognized a $980,909 gain which it termed a "handling fee" (5¢ per share). PGL recognized a gain of $3,923,636 (20¢ per share). Deloitte Haskins & Sells qualified its opinion on the December 31, 1985 PGL consolidated financial statements in respect of, *inter alia*, the gain recorded on the sale of Matrix shares and the resultant increase in the cost of the investment. [Exhibit 283] Donald Cormie said that the disagreement with Deloitte Haskins & Sells which precipitated the qualification was at the instance of Johnson, and that he, Donald Cormie, simply accepted Johnson's expert opinion on the subject. [18870-72] Later, under cross-examination by Mr. Warner, Donald Cormie conceded that he did not know what position Johnson had taken on the recognizing of this gain. [19634] He further did not know whether or not Johnson had changed his position during the course of the audit on the elimination of PNI gains (Transaction #9, *infra*). [19638] Johnson's evidence was that he was unaware why Matrix shares were transferred to AHL [6508; 7111], and while he suggested the PNI transaction [6525] he would have eliminated the gain on consolidation owing to the position taken by the auditors [7121-2], and that generally he would eventually defer to the auditors' judgment on GAAP. [7341] I find that Donald Cormie precipitated the audit qualification by refusing to eliminate the gain and further, that he was not, in doing so, acting on the advice of Johnson.

As a result of the transaction, FIC and AIC reduced their recorded expenses and increased their recorded income for 1984 and 1985 in the amount of $10,790,000. There was no effect on the consolidated financial statements of PGL except for the gain booked through the mechanism used to satisfy the indebtedness.

Schenkelberg was of the opinion that Matrix shares through 1984 and 1985 were worth 19.725¢ each. [35968-9; Exhibit 611] Based on that valuation, which I accept, the total value returned to FIC and AIC was $3,869,686.20. I do not accept that blocks of millions of Matrix shares were worth 55¢ per share. The Matrix shares were thinly traded on the ASE. The public float was approximately 1,000,000 shares in late 1985. [Exhibit 596 at 69] The total number of shares issued and outstanding exceeded 61,000,000. Liquidation of over 19,000,000 Matrix shares on the ASE was not feasible without driving down the price. At least one witness agreed with this common sense proposition. [Smith, 34670-2] The shares themselves were non-earning. FIC and AIC never attempted to dispose of any of the shares on the ASE and convert them to cash.

A PGL directors' resolution, signed by all the directors, dated January 15, 1986, ratifies and confirms a resolution of the directors dated December 31, 1984, whereby PGL waived subordinated note interest due for the period January 1, 1984 to December 31, 1984, and the 1984 levies. Accordingly, part of the "debt" outstanding by PGL to the investment contract companies had been outstanding from the year ended December 31, 1984 until the year ended December 31, 1985, when this transaction occurred.

The reason for the transaction was said to be that PGL wished to provide assistance to FIC and AIC by way of a capital injection. Therefore, the charges were to be forgiven and restored to FIC and AIC. [Donald Cormie, 18868; James Cormie, 14906-7; Marlin, 12116-20] Donald Cormie testified [20465] that he approved the transaction in principle and added that the stock markets were very strong and there was a good opportunity of making an upside gain on Matrix shares. [18868-70]

Two questions arise: first, why AHL was involved in the transaction; and secondly, why the indebtedness was satisfied through the transfer of Matrix shares instead of by payment of cash.

James Cormie's evidence concerning why the shares were transferred to AHL was as follows:

> Q Now, you are saying that this had to leave consolidation before going back down?
>
> A That's correct.
>
> Q What do you mean by that?
>
> A If Principal Group, in essence, gave Matrix shares to First Investors directly, Principal Group is taxable on the difference, in essence, between cost at market, okay? But First Investors, being a subsidiary of Principal Group, could not have its cost any different than Principal Group's cost. So in essence, the gain is wiped out on consolidation and yet the taxes have to be paid.
>
> Q That's the gain to Principal Group Limited?
>
> A That's the difference between cost and market.
>
> Q It is a gain to Principal Group Limited?
>
> A That's correct, and a cost adjustment to First and Associated.
>
> Q It goes through Athabasca because Athabasca is not part of PGL Limited for the purposes of consolidation?
>
> A That's correct.

This proposition was put to Johnson, who pointed out that an election under the *Income Tax Act* could be filed, allowing transfer at cost without tax consequence. [7539-40] I do not accept James Cormie's evidence on this point.

As to the second question, James Cormie explained [14236-7] that if PGL had to pay back cash to FIC and AIC, it would probably not have waived the levies and subordinated note interest because that cash had already been expended to pay the operating expenses of PGL. James Cormie was unwilling to state that PGL did not have any cash to repay, but said that PGL "might not be able to give back cash at that point" [14227], that he could not remember whether PGL "had the cash necessarily right then" [14237], and that PGL was "very insistent" not to pay cash. [14237] Matrix shares were felt to be equivalent in value, and it was felt that over time they would be "quite valuable as well". The shares were non-dividend yielding. [14895] James Cormie added [14909] that the Matrix stock would help FIC and AIC if they could later sell it at a profit and testified that there was a realistic prospect of the companies selling 19,000,000 of these shares at a higher price. He testified earlier [14899] that in or about December, 1985 it would be very hard to get buyers for those shares at 55¢ each although he was unwilling to concede that the companies could not realistically dispose of those shares on the market at 55¢. Johnson was of opinion that it was unlikely that a block of this size could be sold on the public market at 55¢ each. [7115-6]

I find that it was extremely unlikely, if not impossible, that blocks of Matrix shares could have been liquidated through sale on the ASE for 55¢ at that time. I further find that no one could reasonably believe that they could sell at 55¢.

Donald Cormie testified [17414-9] that the method of completing the waiver of the levies and note interest, moving the stock from PGL to AHL before transferring it to FIC and AIC, was designed so that PGL could realize a gain. He testified [18869] that the structure of this transaction was suggested by Johnson. Johnson, on the other hand, said James Cormie issued the instructions [6508] and that he, Johnson, was not aware why Matrix shares were transferred to AHL [6508; 7111]. Donald Cormie appears to be confusing this transaction with Transaction #9. It will be seen in relation to Transaction #9 that Johnson had suggested transferring the PNI stock out of the consolidation for a wholly different purpose. James Cormie testified that this transaction was not "necessarily" Johnson's idea, but was "modelled" after it. [15286]

It is apparent from Exhibit 611 at 14 that PGL probably did not have sufficient cash to pay back the levies, even after it sold $2,600,000 worth of marketable securities. While PGL owned approximately $6,500,000 of marketable securities as at the year ended December 31, 1985, approximately $4,000,000 of that was margined. [Exhibit 611 at 17] At the end of 1985, PGL only had $839,912 in cash. [Exhibit 275; 36148; 36265-6]

There is no doubt that one motivation for this transaction was to make an apparent capital contribution to FIC and AIC. By reversing the levies and note interest, the investment contract companies' expenses were reduced, their income was increased, and, to the extent of the transaction, their shareholders' equity was preserved. Improving the state of the balance sheet was important to ensure the best chances of maintaining the licences of FIC and AIC. I also find that PGL was not prepared to, even if it were able to, repay these amounts in cash. Rather, by using Matrix shares PGL could book a gain and that was another motivation for the transaction.

Donald Cormie testified in respect of Transaction #4 that the brewery was transferred to Matrix in order to move longer time horizon, more speculative assets out of FIC and AIC. The oil and gas business was similarly described during his testimony respecting Transaction #6. Now the shares of Matrix, which owned the assets originally owned by FIC and AIC, were transferred to FIC and AIC in this transaction. This demonstrates that Matrix shares became a currency within Principal Group and were moved where and when necessary to settle obligations or modify corporate holdings.

The evidence tends to show that the Matrix shares were over-valued and treated simply as currency. It further tends to show that the prime intention on the part of Donald Cormie and James Cormie was to advance the plan to hide the insolvency of Principal Group.

TRANSACTION #9

In December, 1985 FIC and AIC acquired shares of PNI from AHL. PGL transferred the shares to AHL. AHL in turn transferred them to FIC and AIC in payment on the redemption of AHL preferred shares ($15,287,051) and part of the dividends due thereon ($1,148,000). These AHL shares had been acquired by FIC and AIC in Transaction # 3. PGL booked a gain on the sale of PNI shares to AHL of $10,376,823. [Exhibit 284] FIC and AIC now held $16,435,000 of PNI Class A non-voting shares (865,000 shares valued at $19 each). These shares were traded on the TSE.

Through this transaction PGL settled the $14,040,000 of promissory notes issued in the course of Transaction #4 and interest thereon, satisfied part of the dividend payable for 1985 on the PGL 11.6% second preferred Series 2 shares (Transaction #2, *supra*) ($725,000), and booked a receivable from AHL in the amount of $1,124,085 (this receivable was eliminated in Transaction #7).

Deloitte Haskins & Sells qualified their audit opinion on the consolidated financial statements of PGL for the year ended December 31, 1985 respecting the gain on the sale by PGL of its PNI shares and the resultant increase in the carrying cost of the investment. [Exhibit 274] The qualification was made because Donald Cormie refused to eliminate the profit on consolidation (for a discussion of the evidence on this point, see Transaction #7, *supra*). FIC, AIC and AHL recorded neither gain nor loss on this transaction.

The transaction was said to benefit FIC and AIC by replacing a non-liquid asset (AHL preferred shares) with a marketable asset (PNI shares trading on the TSE). Donald Cormie testified that it was felt that PNI shares might potentially appreciate in value, affording FIC and AIC the opportunity to realize a gain on the sale of the shares. [18878-9] Marlin testified that he was satisfied that the transaction was not prejudicial to FIC or AIC. [12987; 12992-3] Johnson testified [6519-20] that PNI shares were better qualified assets for the investment contract companies than were the AHL preferred shares. Johnson further testified [7121] that had the PNI shares been sold on the open market, there would probably have been some downward effect on the price, perhaps not significant, and definitely not as significant as an open market sale of Matrix shares would have had on the price of Matrix shares.

Donald Cormie also testified [18876] that the PNI stock was very popular. His evidence was that some of it had been bought by Confederation Life, by advisors to certain mutual funds, and "perhaps" by some of the provincial government agencies. He said it was quite liquid, there were substantial volumes of trading, and it had excellent prospects. He said:

> So it appeared that it was an excellent stock for liquidity. It was much better than Matrix because it was on Toronto and it was more widely known. So that it was the thought, it was much more liquid than the Athabasca preferreds and had some upside. [18878-9]

Schenkelberg [Exhibit 611 at 86-7] noted that there is no indication that the share price was unreasonable and that insiders were net sellers of the stock from January through July, 1986.

The transaction was conceived by Johnson, and approved by Donald Cormie. [Johnson, 6525] Johnson testified that he had discussed the transaction with the Alberta regulators, who shared his opinion that an investment in PNI was more worthwhile than the investment in the AHL preferred shares. [6527] It is notable that in this transaction there is actually some documentary evidence of Johnson's participation. [Exhibit 284] In Transaction #7 there is none.

Evidence concerning the purposes of the transaction was as follows. Marlin testified [12127] that they were: (1) booking a profit in PGL; (2) retiring the debt between PGL and AHL; and (3) redeeming some of the AHL preferred shares.

James Cormie agreed that the PGL board decided to proceed with the transaction because it was a profitable one, at least on the books. PGL booked a profit on the sale in excess of $10,000,000. [14269] He also agreed that one of the objects was to cancel the intercorporate indebtedness, and pointed out that FIC and AIC received a more liquid asset. [14992]

Donald Cormie also agreed [17417-8] that one of the reasons for proceeding with the transaction was regulatory pressure and another was to record the $10,376,823 gain in PGL.

It is observed that it was probably beneficial to AHL to eliminate the promissory notes due from PGL. As discussed elsewhere, by this time the evidence tends to show that PGL was probably insolvent. However, FIC and AIC still held shares in companies controlled by the same group.

TRANSACTION #11

On May 30, 1986 AIC acquired from AHL 4,920,000 AHL series 1 and 2 preferred shares at $1 each, in exchange for 4,100,000 Matrix shares at $1.20 each. As AIC had acquired the Matrix shares for 55¢ each, it recorded a gain of $2,665,000.

On December 31, 1986 FIC acquired from AHL 7,206,570 series 18 AHL preferred shares at $1 each, in exchange for 4,869,308 Matrix common shares at $1.48 each. FIC had also acquired the Matrix shares at 55¢ each. It recorded a gain of $4,528,451. [Exhibit 285]

The Series 18 AHL preferred shares were created on December 17, 1986. They were divided into 10 sub-series of equal size. The first sub-series was retractable one year after their issue, the second sub-series, two years after their issue and so on through 10 years. Their dividend rate was the same as that of Series 1; that is, 4% with participation feature. [Exhibit 328 at 254; Exhibit 412]

The AIC subscription for the preferred shares in consideration of the transfer of the Matrix shares was made on behalf of AIC by James Cormie and Marlin and agreed to by Donald Cormie and Petracca on behalf of AHL. Similarly the resolution accepting the FIC subscription was made on behalf of AHL by Petracca and Donald Cormie. [Exhibit 285]

In the case of AIC, a condition of transfer of the shares of Matrix was that AHL would within six months of May 30, 1986 cause the preferred shares it issued to AIC to be redeemed for cash or specie acceptable to AIC. AHL agreed, and the letter to that effect was signed by Donald Cormie and Petracca. [Exhibit 285] There is no evidence of a similar arrangement for FIC. AHL did not redeem the preferred shares. Johnson could recall subsequent discussions with Marlin and with Donald Cormie respecting redemption of those shares for cash, and was advised that there was no cash available in AHL at the time, and hence no redemption.

Johnson testified that as of the end of May, 1986 there was a capital deficiency in the accounts of AIC. Therefore, corrective action had to be taken. The sale generated a gain of $2,665,000 which was sufficient to eliminate (on paper) the deficiency. Johnson testified that there was a standing instruction within the accounting department, in place long before he became employed by PGL, that the monthly statements required to be filed with the Alberta regulators were not to be filed showing a deficiency. Johnson assumed that the instructions came from Donald Cormie. Johnson testified that he was not involved in the December, 1986 transaction involving FIC. [6531-40]

The British Columbia regulators disregarded this gain. [Marlin, 12208-9; Johnson, 7128-9]

Johnson also testified [6538-9] that he suggested that a cash injection or the sale of other securities for cash would have satisfied the capital deficiency in a much more satisfactory manner, and while his recollection was unclear, he testified that his suggestion would have been discussed. He testified that the decision to proceed with this transaction had to be approved by either Donald Cormie or James Cormie.

Marlin testified [12206-9] that the purpose of the transaction was to book a profit in the accounts of AIC, realizing the appreciated value of the Matrix shares. He agreed that such a profit was only seen as an advantage in terms of regulatory pressure. He also testified [13003-4] that in response to regulatory pressure from British Columbia AHL stock was moved back to AIC. It was decided to find a buyer for the Matrix stock so that the proceeds could be used to replace the AHL shares with cash. Ultimately, he said, the cash came from the large block Matrix transactions (Transactions #10, #16 and #17). In reality, the cash did not find its way to AIC. Marlin had no recollection of the December 1986 transaction but acknowledged that he probably executed documentation on behalf of FIC in respect of it. [12206-9; 12507]

James Cormie testified [14314] that the objective of the FIC transaction was to completely eliminate Matrix shares from FIC, after the aforementioned large block Matrix transactions. [See also: Exhibit 409 at 820] He agreed that another reason was regulatory pressure on FIC to dispose of Matrix stock. His evidence was that the AIC transaction was in response to regulatory pressure to remove that stock from AIC. He agreed that "in a way", a reason for both transactions was for FIC and AIC to record a profit. [14315] He also testified that AHL was planning to sell Matrix shares to fund the cash obligation back to AIC. [14319] He added that the FIC transaction was not similar because there was no arrangement that FIC's holdings of AHL preferred shares would be redeemed for cash or acceptable specie. [14321] He said that he was well aware of the FIC transaction and participated in discussions about it. [14321] James Cormie testified [15001] that the benefit of these transactions to FIC and

AIC was that the risk on the Matrix stock was now spread over all of the assets of AHL, rather than FIC and AIC bearing that risk directly.

James Cormie could offer no satisfactory explanation why AIC's preferred shares were not redeemed. He said [14315-20] the letter agreement really meant that if Matrix shares were sold AIC would receive cash. The letter agreement provides:

> . . . Athabasca will within 180 days of this date cause the aforesaid preferred shares to be redeemed at par in cash or in specie provided however that if any or all said consideration or redemption be other than in cash then such consideration shall be in specie acceptable to Associated Investors of Canada Limited. [Exhibit 285]

Donald Cormie's evidence was as follows [17506-12; 18894-7]. The transaction was done to satisfy the British Columbia regulators who, unlike the Alberta regulators, apparently preferred AHL shares over Matrix shares. [17506-12; 18894-7] He stated:

> The B.C. regulators didn't like the Matrix shares and they thought that the Athabasca preferred was a better investment. They wanted the Matrix shares, if they were going to be kept, to be written down to the original book of any of the companies in the group. So, in effect, it would have searched back through all transactions and established that carrying value was the first value anywhere in the group.

Therefore, since Matrix shares were "fairly high" in value and there was a fairly active interest at the time in the stock, he said, it appeared best to place them in AHL in exchange for its preferred shares. [17507-8] Finally, he testified that this transaction would "lock in current value" of Matrix and allow it to continue to hold Matrix shares at that value. [17512] He acknowledged signing documentation in respect of this transaction on behalf of AHL.

I find that the purposes of these transactions were first, to move the Matrix shares to AHL in order that any deficiency, perceived or real, in value of the Matrix stock could be supported by other assets in AHL, and secondly, to record gains in the financial statements of FIC and AIC. The transactions were in that sense in response to regulatory pressure. When the regulators criticized the value ascribed to a particular asset, the asset was simply exchanged for some other asset within the Group; however, nothing really changed in terms of the true financial condition of FIC and AIC and no real gains were enjoyed. I find that Donald Cormie, James Cormie and Marlin decided to, and did, carry out these transactions.

TRANSACTION #12

On June 2, 1986 FIC and AIC were granted an option to put 2,355,000 PNI class A shares to AHL in exchange for AHL preferred shares. The PNI shares were obtained in Transaction #9 and were subsequently split 3:1. The option was open from June 2, 1986 to December 31, 1986 and was exercised on December 19, 1986. FIC and AIC received AHL series 17 4% preferred shares with a face value of $14,907,150. Series 17 preferred shares carry the same dividend rate as series 1. They were issued in 10 sub-series of equal size. The first sub-series was retractable 1 year after their issue, the second sub-series in 2 years, and so on over 10 years. [Exhibit 412] The series 17 shares were created by resolution dated December 17, 1986. There was no gain or loss recorded by FIC and AIC.

The option agreement was executed on behalf of AHL by Donald Cormie and Petracca. Marlin, Petracca and Espenberg authorized FIC and AIC to enter into the transaction, and Marlin and Petracca executed the agreement on behalf of FIC and AIC.

On June 2, 1986 PGL transferred its 1,618,035 PNI common shares at $7.99 per share to CSI in exchange for a promissory note from CSI. The promissory note was payable on demand with interest at prime. [Exhibit 287] $12,932,954 of the intercorporate debt between PGL and CSI is attributable to this transaction. The directors resolution of CSI approving the purchase of the shares and the issue of a promissory note to PGL was signed by Donald Cormie and James Cormie but not by John Cormie or Marlin.

The option agreement was said to be protection for FIC and AIC from downside risk on Transaction #9. [Exhibit 409 at 822-825] The protection was put in place 5 months after Transaction #9.

Johnson testified that he could discern no purpose for the exercise of the option by FIC and AIC. By December, 1986 PNI had suffered a loss in its investment in seismic operations, after the price of oil declined in February, 1986, with a consequent unfavourable impact on the price of PNI shares. However, he said, the transfer should not have avoided writedowns by Principal Group on the carrying value of PNI shares for the year ended 1986, because whether the PNI shares were held directly or in AHL, the valuation question should have been the same. He testified that James Cormie authorized this transaction. He said that the better asset to have probably would have been the PNI shares although in hindsight, given the loss in value of the seismic operations, either investment was about as attractive as the other. [6552-8; 7545]

Johnson later clarified [7136] that while the write down of PNI shares would indirectly affect the value of the AHL preferred shares, those preferred shares might not be written down owing to a decline in the value of PNI shares, because the PNI shares were not the only assets of AHL. As noted on numerous occasions in respect of preceding transactions, this was, the evidence tends to show, a common means used by senior management to avoid writedowns.

Johnson understood from discussions with either Donald Cormie or James Cormie that the transfer of the voting shares to CSI was for the purposes of removing PNI from the PGL consolidation. All of this occurred after PNI encountered significant problems with its seismic program in the second quarter of 1986. [7133-7]

Marlin testified [12213-4] that the option was exercised due to a decline in the value of PNI shares [See also: Exhibit 409 at 819] The option agreement, he said, took the risk out of Transaction #9. [13005-6]

James Cormie testified that the option agreement allowed FIC and AIC to unwind Transaction #9 if they desired. [14270-1] James Cormie testified that the voting shares were moved to CSI because the policy was to have all of the public companies within the CSI framework, and the private financial companies within PGL. [14272] Another reason, according to James Cormie, was that there was some discussion of closing the PNI seismic division, and in that event there would be write offs. By moving the common stock to CSI, the write offs could be removed from the PGL consolidated statements. [14275]

Petracca acknowledged signing documents authorizing the transaction as a director of AHL, FIC and AIC. She relied on Donald Cormie and Marlin, respectively, in signing the deals. [11294-8]

Donald Cormie said that while he was not involved with the investment contract companies' decision, he understood the option agreement was motivated by regulatory concerns. [17515] He later added that it gave FIC flexibility and protected it from a potential downside risk on PNI shares. [18902-3] In another part of his evidence [20468], Donald Cormie said the decision to exercise the option was made at the PGL directors' level, along with the finance department, while Marlin would have initiated it as president of FIC. In still another part of his evidence, he stated in effect that he did not know why the transaction was done. In contrast to earlier evidence at 17515, the following is recorded at 20469:

> Q Well, if you look at the accounting situation, it's said to be a neutral transact[illegible]nsofar as the contract companies are concerned, it doesn't cost them any money, it doesn't make them any money, right?
>
> A Yes.
>
> Q Was the prognosis for the -- but why did the PGL/PNI share deal take place?

A Well, it appears to me -- and again, I can only recollect as best I can, that this was a plan to have First Investors divest itself of the PNI shares and by using Athabasca, they would be able to take the gain on it. But I gather you're -- I don't know, was there a gain on this transaction?

Q Not to FIC or AIC, it was neutral.

A Well, then there was something about B.C. not liking the shares and preferring the preferreds then, was it?

Q Do you know that?

A No, I don't know that. I just know that at the time that the PNI shares were to come out and the preferreds were to go in.

Donald Cormie did know why the transfer of the common shares was executed. It created a "huge profit" in PGL. [18390-1] The profit was $10,177,225. [Exhibit 276 at 16] There is also recognition in Donald Cormie's evidence that a February, 1986 drop in the price of oil took a "huge toll" on PNI. [18878-9]

The common share transfer had two motivations. First, the evidence tends to show, it was to hide a potential loss in PGL. In fact, the draft 1986 CSI financial statements as of May 29, 1987 [Exhibit 329 at 69-79] show that its auditors, who were not PGL's auditors, were proposing a loss in the value of CSI's investment in PGL ($3,000,000 cost) and PNI ($12,932,954 cost) of $13,000,000. That decline in value, in accounting parlance, was "other than temporary" and would have to be recognized. In the CSI income statement as of December 31, 1986 [Exhibit 329 at 51], CSI's portion of the loss from discontinued operations in PNI exceeded $6,000,000.

The other purpose of the common share transfer was to create a gain in PGL. This gain was, the evidence tends to show, also unreal, available only by virtue of the intercorporate nature of the transaction, whose participants were always willing to trade assets in return for unsecured debt or shares at whatever value considered desirable. Gains within PGL indirectly affected FIC and AIC since one of the assets within AHL was the $12,500,000 of PGL preferred shares.

The transfer of the PNI shares to AHL was also designed to avoid writedowns in the books of FIC and AIC. By placing the stock in AHL, any excess value there would offset any loss in the value of PNI shares. While PNI shares would likely be written down, there was a better chance that AHL preferred shares would not be written down. The transaction only inserted an intervening corporate entity between FIC and AIC and the PNI stock. Donald Cormie said the same thing in a different way:

Q . . . what advantage there would be to the contract companies for getting rid of marketable shares in Neo-Tech [PNI] with good upside potential in return for non-marketable Athabasca shares bearing 4 percent with 2 percent participation?

A Well, to reduce its risk.

Q Reduce its risk?

A Yes.

Q Athabasca was less risky?

A Athabasca would be less risky, yes, in that it wouldn't be fluctuating with the market. [22241]

Donald Cormie already testified as to what happened to the market for PNI shares. The transaction only reduced a risk of accounting writedowns on PNI shares. This PNI stock never seemed to be sold out of the Group. Donald Cormie attributed that to the risk of placing a block on the market and realizing substantially less cash. [22243-5] Therefore, the evidence tends to show, writedowns had to be hidden through intercorporate transactions. Neither a *bona fide* third party nor the market participants would pay as much.

The persons responsible for deciding to execute the FIC and AIC transaction are Donald Cormie, James Cormie and Marlin. The common share transfer was at the instance of Donald Cormie and James Cormie.

TRANSACTION #8

On December 31, 1985 AHL sold the Northwest International Bank and Trust Company (the "Bank") (and related Canadian dollar futures contracts and U.S. T-Bills) for $22,968,409 to CSL. Of that amount $22,854,000 was attributable to the purchase price of the Bank. AHL booked a pre-tax gain of $1,233,516. The net gain was $792,642. [Exhibit 336]

The consideration for the sale was: (1) satisfaction of the debt owing by AHL to CSL in the amount of $17,010,279; (2) an unsecured demand promissory note made by CSL, bearing interest at 10% per annum payable annually, in the face amount of $3,696,896; and (3) some stocks and affiliated mutual funds. The auditors of AHL, Peat, Marwick, Mitchell & Co. concluded that the receivable of $3,696,896 was collectible. [Exhibit 336]

Pearce had valued the Bank as at December 31, 1985 at an amount between $23,868,284 and $25,119,872. [Exhibit 336; 7706] He concluded that fair value ranged from $21,338,809 (adjusted book value) to $25,119,872. Therefore, he concluded the sale price of the Bank ($22,854,000) was fair. The proposal to transfer the Bank and settle the debt was made on behalf of AHL by Pearce, and accepted by Donald Cormie on behalf of CSL. Donald Cormie is President and a director of both companies.

Pearce testified that at the time, he was told by Donald Cormie that because AHL's financial affairs were reviewed by Alberta regulatory authorities owing to its involvement with FIC and AIC, the Department of National Revenue, Taxation might attempt to establish that the mind and management of the Bank was in Canada, and if so, there were tax consequences. It was best that the Bank be moved to a company that was not under regulatory review. [7701-11]

Marlin also testified [12121-5] that this was the reason given to him by Donald Cormie for the transfer. Marlin said he was assured that the value of the consideration received by AHL in payment of the purchase price for the Bank was equivalent to the value of the Bank, although he did not understand the form of the payment, and was not aware of how the payment was in fact made.

James Cormie said the primary reasons for the transfer were as follows. [14258-9] First, there were significant tax problems if money was drawn out of the Bank. Secondly, the mind and management of the Bank had to be separated from Principal Group for tax reasons. Thirdly, the Inspector General of Banks of the Cayman Islands did not like banks under his regulatory purview subject to the possibility of regulatory control by a regulatory body in some other country.

Owing to the tax problem, the transaction created an advantage to AHL, according to James Cormie, because the Bank, upon liquidation and transfer of the cash to Canada, would realize "significantly less" than the sale price in this transaction. Because the transaction cancelled debts owing by AHL, it got the "equivalent" to cash. [14260-1]

I make the following comments on James Cormie's evidence. First, if some tax problem affected the value of the Bank, there is no evidence that the purchase price was similarly adjusted in Transaction #3. Secondly, most of AHL's debt to CSL was incurred on the acquisition of what the evidence tends to show were over-valued PGL preferred shares issued by an insolvent corporation.

Donald Cormie's evidence concerning the reasons for the transfer was as follows. [17444-50; 18873-6] First, the Alberta regulators did not like the Bank being an asset of AHL. Donald Cormie first testified that Marlin told him this [17447]; later that he was not sure who told him. [18874]

Secondly, any monies received from the Bank would be subject to fairly heavy taxation in Canada. Thirdly, Alberta regulators did not like the AHL preferred shares because of the existence of the CSL debt. Fourthly, the mind and management issue described above. Fifthly, regulatory personnel in the Cayman Islands were objecting vigorously to any foreign regulatory body having any jurisdiction or attempting to exercise jurisdiction over one of "their banks". Finally, the Bank looked like a good vehicle to get into the international mutual fund business.

Donald Cormie originated the transaction. [17449] He testified that CSL never took any money out of the Bank. [18342]

AHL was supposed to be only a facilitator for Transaction #3 in the first instance. FIC and AIC paid for the Bank. The bulk of the debt owing to CSL came about as a result of Transaction #2, whereby AHL became indebted to CSL for $12,500,000 together with interest thereon at 12¾% (which was accrued). In the result and looking through the veil (AHL), FIC and AIC had now lost the Bank, and were left with over-valued PGL preferred shares, Allarco, PNI shares and Matrix shares.

TRANSACTION #13

As was the case in 1984 and 1985, the administrative levies and subordinated note interest paid in cash by FIC and AIC to PGL during the year 1986 were reversed. As a result PGL considered itself indebted to FIC and AIC. The amounts were $1,659,804 for AIC and $5,098,786 for FIC. [Exhibit 288]

The levies and note interest were reversed on December 20, 1986. AHL assumed PGL's liability to AIC in exchange for a demand promissory note receivable from PGL bearing interest at prime. On the same day, AHL paid the liability by transferring to AIC 1,276,772 common shares of Matrix valued at $1.30 per share. [Exhibit 288] Insider trading reports were filed in February, 1987. [Exhibit 289A]

James Cormie testified that without AIC's agreement to accept Matrix shares, the transaction would not have been done. [14327-8] Donald Cormie testified that this was a gift to AIC, and in addition, AIC got a potential for capital appreciation on those shares. It was, according to Donald Cormie, beneficial to AIC. [18904-5; 22113]

The PGL directors' resolution also waived the FIC levies and subordinated note interest. Both James Cormie and Donald Cormie testified that this was to be conditional upon completion of Transaction #19. [14330-1; 17525-6] Approximately $1,200,000 in cash was paid by PGL to FIC in the first quarter of 1987. [6559-62] Because he did not manage the cash, Johnson could not explain why the balance was not paid. He noted that owing to PGL's internal organization, no instruction from him, the Vice President of Finance, was necessary to enable repayment. [6563]

Although Donald Cormie denied it [22906], PGL did not have the money to fund the reversals with cash. At December 31, 1986, PGL had $1,899,441 in cash. It had $22,093,113 in marketable securities; however, a large number of these were highly margined because the collateral and secured loans balance owing was $20,847,890. [Exhibit 611 at 21]

Petracca and Donald Cormie signed the AHL resolutions authorizing the transaction. AIC resolutions were signed by its directors. In both instances, Petracca said she relied on Marlin and Donald Cormie. [11297-300] Both Donald Cormie and James Cormie denied playing a part in AIC's decision to accept the shares. [14327-8, 17520; 22091-6]

This transaction is more evidence tending to show attempts to make the investment contract companies' financial statements look better. Again, no cash was used for the repayment to AIC, but rather Matrix shares, another form of currency within Principal Group, were used. I have already commented on FIC's situation in respect of Transaction #19.

TRANSACTION #14

PS&T purchased the Derrick Plaza from 321635 Alberta Ltd. ("321635") on December 19, 1986 in exchange for $2,580,000 cash and $3,871,413 of owned property and mortgages at book value. 321635 had acquired Derrick Plaza a few days before for $1,750,000. [Exhibit 290] 321635 was managed by James I. Hunter, an Edmonton businessman who, through various numbered companies, was prepared to assist Principal Group in various transactions as long as his lawyers were satisfied that the transaction was not illegal, and he was satisfied that there was no risk.

The mortgages and real estate transferred to 321635 had been reserved down on PS&T's books to approximately $800,000. [14355] Management felt they were worth $100,000 to $200,000. [14357-8; 15002-5] John Cormie felt the total real acquisition cost (cash plus properties) would be about $2,800,000. [9512] PS&T had a preliminary appraisal of Derrick Plaza by November 24, 1986 indicating a value of $4,600,000 [Exhibit 364 at 99] and later a detailed appraisal dated December 1, 1986 indicating a value of $5,056,000, both based on the assumption of 90% occupancy.

Management of PS&T believed that Derrick Plaza had great potential in that it could be substantially leased up. [Donald Cormie, 17652-661; 18906-7] On the other hand, Johnson recommended that PS&T forfeit its deposit and not complete the deal; it did nothing for PS&T, and "you don't pay 800 and some odd thousand dollars more for a building virtually the same day than the purchaser acquired it for". [6575-7] He was aware of this prior to closing [7149] and had a long discussion with James Cormie as to why PS&T should back out of the deal. [7150-1] James Cormie, on the other hand, said the speculation was that Hunter had paid about $2,200,000 for the building. [14359-60]

John Cormie testified [9332-8; 9512-3; 9709-10] that his objective was to prevent any writedowns on the book value of a group of assets by acquiring a property at a certain price and managing it up in value to support the book value of the other assets, allowing PS&T to recover CDIC reserves (which affected unimpaired capital calculations and, *inter alia*, the amount of money that PS&T could borrow from the public based on a capital ratio test) or support value. CDIC had already placed reserves against the traded properties and management was concerned that the auditors might now write down those assets; "what we hoped to accomplish in discussion with the auditors is to maintain the book value of the assets traded in this remaining asset which was Derrick Plaza . . .". His evidence was also that Aboussafy had been looking for a property to "handle certain aspects of our balance sheet presentation". The Chairman of the Board of PS&T, Donald Cormie, gave similar evidence as to the objective. [18906-7] Aboussafy's evidence was that this transaction would be approved by Donald Cormie. [4053] Certainly Donald Cormie was aware of the proposal as it proceeded. [17653-60]

CDIC reserves against the properties amounted to $3,871,413, but no accounting writedown had been made. By recording the building at $6,451,413 PS&T could attempt to recover (that is, eliminate) CDIC reserves as the building appreciated in value. [6579-80; 9343-4]

Deloitte Haskins & Sells decided to allow PS&T to carry Derrick Plaza at its cost, which they assessed at $3,369,000. Since PS&T had recorded Derrick Plaza at book, $6,451,413, there was a writedown of $3,082,413 required [Exhibit 290 at 114] and ultimately, no gain or loss was shown. [6572-3]

As noted, John Cormie testified that an objective of the transaction was to support the book value of the assets traded. John Cormie swore an affidavit of transfer [Exhibit 246B] that the present value of the property was $6,451,413. He acknowledged that the appraisals showed the property to be worth less and that the $6,451,413 figure was chosen to preserve the balance sheet book value of the properties being traded. When confronted with the affidavit of value, he testified that when he swore what the value was, he meant "book value". He also said that "present value" meant the "transaction value", and the "transaction value" was done at "book value". [9711-18]

Aboussafy said that an additional purpose of the transaction was to consolidate management responsibilities. 321635 would receive the owned properties and mortgages and would be responsible for their management, while PS&T would now only need to deal with one property, the Derrick Plaza. [3922-5] In a letter dated November 24, 1986 and addressed to Pointe, Aboussafy described the objective of PS&T as trading low and non-performing assets for currently performing assets with the potential to increase in value over the medium term. Consolidation of management responsibilities was described as a "benefit". [Exhibit 364 at 83] I have also noted that as soon as Derrick Plaza was bought, another of the companies managed by Hunter became the property managers, as well as owners of the other mortgages and owned properties. This sort of evidence indicates to me that property management can be obtained by agreement.

I am led to conclude that consolidation of management responsibilities was not the motivating force — or even a purpose — of this transaction, but rather a collateral benefit. John Cormie, the President of PS&T saw the purpose of the transaction as being to maintain book value. So did Donald Cormie. Moreover, some of the GE Mortgages (Transaction #5) were split and sold in this transaction to 321635 because, according to John Cormie, their values were "shaky". I do not accept that mortgages need be moved from one "professional manager" to another and given that they were, I conclude that I can not accept the professional management theory as a motivating factor for the transaction.

An issue which arose during the course of the public hearings was whether this transaction was connected to Transaction #10, *infra*. 321635 is managed by James I. Hunter. PS&T outlined a proposed purchase of the Derrick Plaza to Hunter on October 29, 1986. PS&T made its formal offer to purchase on November 27, 1986 and it was accepted on the same day. Also on the same day, 356538 Alberta Ltd. (also managed by Hunter) obtained an exclusive leasing agreement from PS&T and entered into a property management agreement. [Exhibit 375]

In the meantime, on November 18, 1986 Hunter received from Patrick some drafts for the proposed deal referred to in the hearings as Transaction #10. [Exhibit 375] On November 28, 1986 Transaction #10 was consummated with 356539 Alberta Ltd., another company on whose behalf Hunter was acting in these transactions.

On December 29, 1986 Aboussafy forwarded Hunter's solicitors a cheque in the amount of $2,280,000 to be held in trust in the matter of the purchase and sale of Derrick Plaza. The letter specifically provided that $500,000 was to be used to conclude the mutual fund purchase in connection with the Matrix share sale (i.e., Transaction #10). The sum of $500,000 was the amount Hunter was to contribute to Transaction #10 (*infra*). [Exhibit 375]

The corporate officers who testified with respect to this matter disclaimed any connection between these two transactions. [John Cormie 9345-7; Patrick 8886-7; 8895; Aboussafy 10591-2; Marlin 13014-5] They conceded a possible connection upon presentation of the written record of Aboussafy's instructions; however, they denied being aware of the instructions. Patrick, in particular, said he knew nothing of the Derrick Plaza transaction. Aboussafy, on the other hand, testified that his December 29, 1986 letter was drafted with Patrick's input. [10608] Aboussafy said it was Patrick's instruction. Hunter also was told of no connection although he assumed that if he did not proceed with Transaction #10, the building deal might be in jeopardy. [10491-2]

I find that the evidence before me is inconclusive as to whether the two transactions were linked.

PS&T's activity in acquiring Derrick Plaza is yet more evidence demonstrating that the motive of placing properties in the hands of experienced developers, which was said to be a factor in Transactions such as #3 and #5, was not truly an important motivation within Principal Group, and that the suggestion that FIC bought PS&T's properties in Transactions #1 and #19 because it was better able to manage them, is also simply not true. The transaction is also further evidence of activity tending to show a plan to hide losses and Group insolvency.

TRANSACTION #10

This "transaction" actually consists of 4 separate transactions. The first transaction of this type occurred in November, 1986. CSI agreed to lend $2,500,000 with interest thereon at Royal Bank prime plus 2.5% per annum to 356539 Alberta Ltd. (a company managed by James I. Hunter and hereafter called "Hunter") for the purpose of acquiring PCF shares, PVF shares, CMF shares, and Matrix shares. The transaction was authorized by CSI by directors' resolution dated November 30, 1986 and signed by Donald Cormie, John Cormie, Marlin and James Cormie. The resolution specifically refers to the below-mentioned agreements concerning mutual fund units and Matrix shares. Hunter pledged the Matrix shares and mutual fund units as security on this loan. The charge on the Matrix shares was subject to a prior charge in favour of FIC for $2,500,000 plus interest. The mutual fund collateral security was also subject to the prior claim of Hunter for $687,500 (the "matured return"). In each of these transactions, CSI borrowed the funds it required to make the loans from PGL. [Exhibits 341 and 341A]

Hunter and CSI entered into a put agreement dated as of November 20, 1986. By that agreement, CSI granted to Hunter, from midnight, May 30, 1988 until 11:59 A.M., May 31, 1988, the right to sell to CSI the mutual fund shares. The purchase price was $687,500 plus the lesser of (1) current market value of the shares on the date of the exercise of the option and (2) the value of the liabilities, being the principal and interest on the various loans. A call agreement was also executed, allowing CSI to purchase the mutual fund shares at any time from the date of the agreement until noon, May 31, 1988. The purchase price was the same as that provided for in the put agreement. [Exhibit 341]

The two corporations also entered into put and call agreements in relation to the Matrix shares. The purchase price used in these agreements was $1.30 per common share. The exercise periods in the put and call agreements were identical to those provided for in the mutual fund put and call agreements. [Exhibit 341]

On November 30, 1986 CSI lent $2,500,000 to Hunter. Concurrently, Hunter purchased from FIC 3,846,153 Matrix shares at $1.30 per share, for $5,000,000. Payment was $2,500,000 cash (funded from the proceeds of the CSI loan) and a $2,499,998.90 promissory note payable to FIC. The note was secured by a first charge on the Matrix shares. Recourse on the note was limited to the Matrix shares. The shares were not sold through the ASE. [Exhibit 341]

In addition, FIC made a $4,500,000 margin account loan to Hunter with which Hunter was to purchase, with an additional $500,000 of its own cash (which was part of the proceeds on Derrick Plaza, Transaction #14, *supra*), $5,000,000 of the mutual fund shares. The margin account loan was limited in its recourse to the mutual fund units and recourse was "subject to" the prior claim or "matured return" of the investor described above. FIC's security on the mutual funds was in priority to that of CSI. [Exhibit 341]

As a result, Hunter was to earn a $187,500 return on its $500,000 investment over a period of 18 months, equating to an annual return of 25%.

Three similar transactions were consummated with East West Canadian Investments Inc. ("East/West"), a company whose shares are registered in the name of a nominee, David G. Finlay, and is, in fact, a syndicate of investors. There is no evidence that East/West is in any way related to the Principal Group. Each transaction was authorized on the part of CSI by a CSI director's resolution signed by all the CSI directors.

EAST/WEST #1

This transaction was identical to the Hunter transaction described above except as follows:

(1) East/West was the purchaser and borrower;

(2) the investment period was to be 2 years rather than 18 months;

(3) the transaction documentation was executed on December 29, 1986 and the share transfer was transacted on December 30, 1986 [Exhibits 415 and 596];

(4) 3,401,360 Matrix shares were sold at $1.47 per share;

(5) the "matured return" was $1,000,000 rather than $687,500;

(6) the annual return to East/West on this transaction equates to 50% per annum; and,

(7) the Matrix shares were traded on the floor of the ASE.

EAST/WEST #2

This transaction was identical to the East/West #1 transaction, except that the transaction documentation was executed on December 30, 1986.

EAST/WEST #3

This transaction was identical to the previous East/West transactions except that the $5,000,000 of Matrix shares were purchased from PGL instead of FIC, the number of Matrix shares sold was 3,125,000 at $1.60 per share, the mutual funds sold were slightly different, and the transaction was executed (again on the floor of the ASE) on March 13, 1987. Because PGL sold the Matrix shares, it advanced the $2,500,000 Matrix loan in this transaction, while FIC advanced the $4,500,000 margin loan. [14281]

As a result of these transactions FIC booked profits of $9,143,120 in its financial statements for the year ended December 31, 1986. The East/West #3 deal took place in 1987, and had the gain been booked in the year end statements, PGL would have shown a profit on the deal of $4,062,500. [Exhibit 341]

Except in the case of East/West #3, the mutual fund margin loans and the debts due to CSL and FIC bore interest at prime plus 2.5% per annum. In the case of East/West #3, all loans bore interest at prime plus 3.5% per annum.

Insider trading reports were filed. [Exhibit 289A; 14995] In the case of East/West #3, a report was filed by East/West, but not FIC.

SUMMARY OF THESE 4 TRANSACTIONS

Purchases	**Hunter**	**East/West 1**	**East/West 2**	**East/West 3**
Matrix shares	3,846,153	3,401,360	3,401,360	3,125,000
(Price per share)	$1.30	$1.47	$1.47	$1.60
Purchase Price	$ 5,000,000	$ 5,000,000	$ 5,000,000	$ 5,000,000
PVF	183,992.64	183,992.64	183,992.64	166,112.957
CMF	101,214.574	101,214.574	101,214.574	96,200.096
PCF	162,601.626	162,601.626	162,601.626	141,643.059
Purchase Price	$ 5,000,000	$ 5,000,000	$ 5,000,000	$ 5,000,000
Total	$10,000,000	$10,000,000	$10,000,000	$10,000,000
Funding				
FIC	$ 7,000,000	$ 7,000,000	$ 7,000,000	$ 4,500,000
PGL	—	—	—	$ 2,500,000
CSI	$ 2,500,000	$ 2,500,000	$ 2,500,000	$ 2,500,000
Cash from Investor	$ 500,000	$ 500,000	$ 500,000	$ 500,000
TOTAL	$10,000,000	$10,000,000	$10,000,000	$10,000,000

Pearce testified [8000] that these transactions were to be "warehousing arrangements". His evidence pertaining to that term is reported in respect of Transactions #16 and #17 *infra*, and is not repeated here. He testified that the concept of the transaction was introduced to him by James Cormie and Marlin. [8003; 8411] He also testified [8418] that Donald Cormie's concept of warehousing was that, if another institution took a block of this stock for a certain period, it would help to demonstrate that there was some value to Matrix shares.

Patrick testified that he received his instructions from James Cormie [8741; 8888] in relation to the Hunter transaction.

Marlin testified that his introduction to the concept was from Donald Cormie at a PGL directors' luncheon in November, 1986. [12180-4] The main purpose of the transaction according to Marlin's understanding was to exchange cash for FIC's Matrix stock and to book an unrealized gain. [12993]

James Cormie testified [14277-8] that the concept was designed to move the Matrix shares out of FIC and AIC in response to regulatory pressure, and that the board of directors of PGL felt that it was a good idea and agreed with the concept. James Cormie testified that a very important component of the transactions to the investors was that there was no downside risk. [14283] Mutual funds were matched with Matrix shares to make the package more saleable. [14286] The deals were conceptualized at the PGL director level. [14285-6; 15055] He considered the role of PGL and CSI crucial; FIC and AIC were just there to sell the stock. [15257-8]

The Hunter transaction was private; that is, FIC simply transferred the stock to Hunter outside the facilities of the ASE. The Matrix share transfers involved in the East/West transactions, however, were executed on the floor of the ASE, and thus the volume of the trades was reported in the financial news media. James Cormie testified [14296-303] that the primary reason for trading the Matrix shares involved in the East/West transactions across the floor of the ASE was to "validate" the price for tax purposes and anyone else who might inquire as to how the prices were established. There would be no question as to how the price was arrived at, such as 20 days' previous trades, bid and ask, or anything else. He later said [14473-5] that the reason for trading them on the floor of the ASE was to "justify" the price to regulators, auditors, accountants and taxation authorities, and to spare PGL the inconvenience of keeping data showing how the price was established. Having observed the demeanour of this witness, and noting that the prices were established by written agreements and that the sale of Matrix shares in the Hunter transaction did not cross the floor, I do not accept his explanation.

Donald Cormie testified that it was felt desirable to move the Matrix stock out of FIC. The stock market had been rising since 1982 and there could be some correction. Owing to the large writedowns in real estate, it was important that FIC pick up whatever gains were available. In addition the audit qualification to the PGL consolidated financial statements relating to PNI and MIL would remain unless the stock was moved. [17486-502; 18885; 18890-3] The concept, he said, was developed at the PGL directors' level, with the put and call aspect originated by James Cormie and Donald Cormie. Donald Cormie testified that, unknown to him, the down payments (the "matured returns" referred to earlier) took priority on liquidation of the mutual funds. This he attributed to the legal department. [17492] I do not take that evidence to mean that Donald Cormie did not know there was a fixed, guaranteed return to the investor, and if he meant that, I do not believe him.

On a net basis, in each case where FIC sold Matrix stock, it did receive $2,500,000 in cash. It also received a $2,500,000 limited recourse promissory note, which had nothing to do with cash. In each case, FIC made a $4,500,000 margin loan. This money would be advanced for purchasing the mutual funds. All of the funds purchased were managed by PSML. FIC was not at risk unless the value of any security dropped and CSI defaulted on its obligations to honour a put. In consequence, the risk was shared by FIC and CSI.

After the failure of FIC and AIC on June 30, 1987, these transactions were collapsed. FIC suffered no cash deficiency. On the Matrix loans, the amounts outstanding did not represent cash advances in the first instance. FIC got back exactly what it had in the first instance. It was also made whole on the margin loans. However, it is questionable that Matrix shares were of sufficient value to support the amount of Matrix secured loans shown on its books. The issued and outstanding shares of Matrix exceeded 61,000,000. At $1.47 per share, one might conclude that Matrix was worth in excess of $85,000,000, which it was not. In reality, the stock was thinly traded and the blocks of stock simply were not worth the value ascribed to them on a per share basis.

The evidence tends to show that the transaction was simply an attempt to convert a stock of questionable value into a loan — an attempt to realize value on a stock that, without the aid of CSI and nominee companies, could not be realized on a public market. FIC did receive some value in the form of loan proceeds from CSI, but at the expense of PGL creditors (which includes FIC itself). It is another example of assets moving among the Group, without new value being introduced, and is part of an overall strategy to book gains where none existed, in this case as in others with finances obtained from the public through the sale of PGL promissory notes. Donald Cormie, James Cormie and Marlin were in fact responsible for executing these transactions.

TRANSACTIONS #16 and #17

On November 17, 1986 AHL opened a margin account at Levesque Beaubien, a brokerage firm ("Levesque"). On November 20, 1986 AHL deposited $800,000 into the account, and CSI advanced $8,000,000 into the account. Both CSI and AHL borrowed the money from PGL. [14389; Exhibit 426] AHL then drew down the margin account and purchased $7,000,000 of Government of Canada bonds (face value) for $8,800,000. [Exhibit 339]

On November 20, 1986 PGL sold 6,154,000 Matrix shares to Levesque at $1.30, for $8,000,200. This sale was reflected as an open market trade on the ASE. [Exhibit 339] This transaction was called, during the public hearings, Transaction #16.

Also on November 20, 1986 AHL and Levesque entered into a put and call agreement entitling Levesque to put its Matrix shares to AHL (that is, require AHL to purchase) for $1.3115 per share, commencing 30 days after the date of the agreement. Levesque also had the option to sell its Matrix shares on the open market, although it did not do so. AHL could call (that is, require Levesque to sell) the Matrix shares from Levesque for the same price, commencing 31 days after the date of the agreement. The term of the agreement was 60 days, whereupon the put and call options expired. The $0.0115 per share spread represented a return to Levesque as compensation for the use of its funds. Levesque was not at risk because the performance of AHL's obligations was guaranteed through the Government of Canada bonds. [Exhibit 339]

On December 22, 1986 Levesque (through Watt) exercised its put option. AHL (through James Cormie) exercised its call on the same day. The resulting trade, also on December 22, 1986, was made over the floor of the ASE. AHL then paid for the shares by selling the Government of Canada bonds and using the proceeds. [Exhibit 339]

AHL repaid CSI by transferring to it 2,556,270 Matrix shares at $1.36, and applying the amount due from CSL plus interest thereon arising from the sale of the Bank (Transaction #8). [Exhibit 339]

PGL booked a gain of $6,149,500 and paid a $4,500 commission to Levesque. AHL booked a gain of $391,564. Including the commission on bond sale and purchase, the Matrix share purchase and the gain on sale of Matrix shares when put back to AHL, Levesque earned $128,157. [Exhibit 339]

The AHL margin account agreements were signed by, and AHL's execution of the put and call agreements was authorized by, Donald Cormie and Petracca. [Exhibit 339 and 340]

Not having sold any Matrix shares on the market and having put the Matrix shares back to AHL over the floor of the ASE on December 22, 1986, Levesque purchased, on December 24, 1986, 5,333,333 Matrix shares from PGL at $1.50 each. This trade was also recorded as an open market trade on the floor of the ASE. Since PGL carried the shares in its books at 30¢ each, it realized a gain of $6,399,999. These same shares were traded between Levesque and AHL at $1.3115 each only 2 days before. [Exhibit 340] This transaction was called, during the hearings, Transaction #17.

On that same day, December 24, 1986, CSI and Levesque entered into a put and call agreement whereby Levesque could put its Matrix shares to CSI at $1.57 each, and CSI could call any remaining Matrix shares for the same price. The term of the put and call options was the period between 128 and 140 days from the date of the agreement. [Exhibit 340]

CSI was authorized to enter into the transaction by its directors, Donald Cormie, James Cormie, John Cormie and Marlin. The directors' resolution is dated December 24, 1986. [Exhibit 340]

Levesque sold 4,700 shares on the market. It exercised its option on May 1, 1987 and thereby put the balance of the Matrix shares to CSI. This transaction was not recorded as an open market trade on the ASE. The shares were put at $1.57 per share. Levesque realized a profit of $378,303. [Exhibit 340]

Once again, Levesque took no risk. There were sufficient government bonds in the CSI margin account to secure CSI's performance of its obligations.

In both cases, Levesque exercised its put option in the shortest possible time permitted under each agreement, notwithstanding that it was permitted to sell the shares on the open market during the hold period.

The sale on Transaction #16 to Levesque and the sale back to AHL both resulted in insider trading reports being filed in February, 1987. In the case of Transaction #17 the sale by PGL to Levesque resulted in a report being filed May, 1987, and it was reported as a May 1, 1987 sale. The put back also resulted in a May, 1987 report being filed, which reported it as a purchase at $1.50. [Exhibit 340]

AHL suffered some erosion to its asset base through Transaction #16. It purchased 6,154,000 Matrix shares at $1.3115 and sold 2,556,270 Matrix shares to CSI at $1.36, resulting in a net cost of $4,594,444. The actual value of Matrix stock was 19.725¢ per share. The excess paid represented a loss to AHL (although not recorded as such) of $3,884,792. [Exhibit 611 at 89] CSI, on the same reasoning as for AHL above, suffered a loss of $2,972,303 on Transaction #16, and $7,314,861 on

Transaction #17. [Exhibit 611] These losses represent in large part the gains realized by PGL. The actual amount of AHL's loss depends on the amount collectible on the CSI receivable. Since it is unlikely that the receivable was fully collectible by the end of 1986, the real loss may be of a lesser magnitude, although one might then be concerned that owing to the intercorporate relationships, AHL was not monitoring the collectibility of the receivable and indeed accepted a large unsecured receivable in the first instance.

Why were these transactions done? Pearce testified that as a result of some meetings with Donald Cormie and James Cormie, Donald Cormie:

> . . . had indicated that he felt that it would be beneficial to the companies to establish value to the Matrix shares, and he explained a method of doing that, which he termed as 'warehousing' of the Matrix stock . . . . [7953]

The concept involved taking a block of stock and placing it with a third party for a fee on the basis of some buy back arrangement or other opportunity for that third party to dispose of the stock without risk. [7951-4] Pearce testified that Donald Cormie would have had to give his approval to do these transactions. [7956]

Pearce testified in addition that: [7956]

> The explanation that was given to me, that it was undertaken to establish the fact that Matrix shares did have some value, and that if a third party would accept those shares under this type of an arrangement, that that would give a reflection of the value to the marketplace.

James Cormie testified [14379-401] that these transactions were a means of moving the public companies to the "CSI framework". [14381] The process involved going through Levesque because "Levesque felt that they could do a little bit with the stock" [14382] which, he said, meant they could sell it into the market. He did acknowledge that if one wanted to move the stock to the "CSI framework" there was nothing wrong with just selling it directly. [14394] He also testified [14384] that it was Levesque's idea to trade it over the floor of the ASE, although the reasons he gave for trading the stock across the market in respect of Transaction #10 were also said to be applicable to this transaction. Under subsequent cross-examination he said that whether or not these trades were put over the market floor did not matter to PGL. [14734] James Cormie acknowledged that he originated the concept of these transactions, and Pearce negotiated them. [14396]

Levesque, as noted above, did not do anything with the stock. The question arose as to why Transaction #17 was undertaken as a part of the movement of the so-called public companies to the CSI framework. James Cormie said [14400] that Levesque "just felt that they could still do something with" the Matrix stock. He acknowledged, however, that Levesque did not approach Principal on either of these deals.

James Cormie's evidence on the transaction is unsatisfactory. As an example, [14458] after spending some time explaining that the large block transactions had to occur between the bid and the ask prices showing on the ASE — which they do not because these were cash transactions — and that he had instructed the broker to do that; and having explained that if the trade could not be done between the bid and the ask prices the parties would have had to either redo the deal or find some other way to do it; the question arose whether any member of the CSI group were party to the asking price on December 23 or 24, 1986. The response:

> What I can say on that is that the only company that I know of that would be involved at all would be Allarco at that time. I, specifically, before anything happened on the trade, went over to Rob Pearce and said, I don't want any bids or offers in there at all today, just to make sure that there wouldn't be anything in there. [14458]

Pearce was on holidays during that time. James Cormie later changed his evidence slightly and said he was not aware of whether related companies were active in the trading of Matrix stock on December 23, 1986. As I have noted elsewhere, I do not accept this evidence. [14477]

Donald Cormie said [17676-9] he had nothing to do with conceiving these deals, and did not know whose idea they were. On that point, Aboussafy testified that in relation to the Hunter deal it was Donald Cormie who introduced him to the concept. [10582-3] Pearce and Marlin also testified that Donald Cormie and James Cormie conceived these kinds of deals. I do not accept Donald Cormie's evidence on this point.

Donald Cormie did, however, state that he would have approved the transaction in its concept, which would have been brought to him at some stage, and further understood the general mechanics of it. He said the purpose of Transaction #16 was to get the stock out of the Group consolidation and have somebody else try to sell it and also enable PGL to realize a gain. On the latter point, Donald Cormie had confirmed in writing in November, 1986 that PGL's benefit was to "come out with a good "Consolidated Statement"". [Exhibit 339 at 57] He said the business reasons were the same in Transaction #17. Donald Cormie testified that he did not consider whether it was proper that these transactions be done on the facilities of a public market, although he was sure that Rob Pearce would be very meticulous on that. [17679-95; 18911]

Donald Cormie testified [18909-15] that the purpose was to put a block of this stock into the hands of a broker who would have an opportunity to sell it, but who probably would not have taken the stock without some protection. This kind of transaction, with a put and call arrangement, is common according to Donald Cormie. He continued:

> Someplace [sic] they call them warehousing, but it is a question of having the stock put in the hands of somebody that would be active in trying to find purchasers in disposing of it without having an undue risk. [18910]

Transaction #17, he said, allowed PGL to realize a gain on the shares, and to move them to CSI which would work to have a secondary issue. He said that the intention here was to have the public shares gradually move out from ownership by the regulated companies and later have the "upper companies" develop a secondary issue. Donald Cormie said that he himself was negotiating in Toronto to dispose of $25,000,000 of Matrix shares with groups who warehoused stock in order to sell the shares to the public later. [18917-20]

Angus Watt, who was the broker who negotiated and conducted the transactions on behalf of Levesque testified [33857-8] that Levesque entered into these transactions for the following reasons, ranked in their order of priority:

1. sufficient collateral to ensure that Levesque did not lose any money;
2. to earn a commission and rate of return;
3. to have some "bonus merit" by having the ability to sell the shares at a higher price.

He said that it was unclear how many shares Levesque might sell; that Levesque did not expect to sell its whole position; that it was possible that Levesque would be able to sell some; and that the ability to sell Matrix shares was an "incentive" to enter the deal. [33859-60] In relation to Transaction #17, Watt also testified that Levesque always had the "expectation and hope" to sell the shares. [33877]

Watt testified that he would not have entered the deal simply for the purpose of acquiring the Matrix shares and distributing them on the market. He had no intention of promoting the stock to his own clients or to bring a secondary distribution of these shares. He testified that while he could not recall, it was a very low probability that he had any discussions with any officer of the Principal Group to the effect that Levesque felt that it could do something with the stock or that it could distribute this stock to the market. He also testified that at $1.30 the stock was "expensive". [33861-2]

Watt testified that Levesque recommended and suggested quite strongly that the deal be done on the floor of the ASE, particularly on the buy side. [33862-3]

Watt testified that he inquired of the Principal Group as to why it was doing the transaction, and the response was that it was for "internal reasons". He did not inquire further. [33856; 33869-70]

Watt also testified [33897; 33955] that at the time, he understood that the policy of the ASE was that these sorts of trades should go over the floor on the buy side, although he acknowledged [33865] that these deals were unusual in Alberta and that nobody had approached the ASE to ask permission that it not be printed on the public market. He acknowledged that the exercise of the put did not have to cross the floor of the ASE.

Watt confirmed that the existence of the put and call agreements were not disclosed to the floor governor of the ASE. [33868-9; 33875-6; 33894-5] As noted elsewhere, the floor governor did not consider that information to be relevant for his function.

While Pearce negotiated Transaction #16 and initiated negotiations on Transaction #17, the evidence shows that the concept was developed and approved by Donald Cormie and James Cormie.

I do not accept that the object of the transactions was to move public companies to the "CSI framework" or that Levesque intended to enter the deal to do anything with the stock except hold it, knowing that it might be able to sell some as a "bonus merit". I do not believe the evidence that Levesque was approached to do the transaction because it felt it could do something with the stock. I do not accept that anyone could believe that Levesque could dispose of all or a substantial portion of blocks of many million shares given the thinly traded market for Matrix. I do not accept that it did not matter to PGL whether or not the blocks were traded on the floor of the ASE. That is exactly what PGL wanted. The purpose of the transactions was two-fold: first to book gains in the accounting records of PGL; and secondly, to justify the values being ascribed to Matrix shares by moving the blocks over the floor of a public market. The second object when accomplished would enable Principal Group to argue that inasmuch as the blocks had passed over the floor of the ASE without interference or complaint of authorities, the stock ought to be valued at the amount of the trade. The transactions are further evidence tending to show a plan to book gains where in reality none existed. AHL was again nothing but a captive buyer of this over-valued stock from PGL.

TRANSACTION #15

Qualico Developments Ltd. ("Qualico") at June 24, 1986 was indebted to AHL, FIC, AIC and CSL for approximately $10,200,000. This indebtedness arose from the sale to Qualico of what are known as the Speedway Lands, pursuant to agreements for sale entered into between Qualico and each of them respectively. As at June 24, 1986, Qualico's indebtedness to CSL was $2,862,325, which had been pledged by PGL (with CSL's permission) as collateral security for promissory notes of $4,200,000 owed by PGL to FIC. Qualico's indebtedness to FIC and AIC was slightly more than $7,000,000, while to AHL it was $300,353. [Exhibit 342]

In June, 1986 Qualico made a payment of $4,305,901 on the agreements for sale. It was agreed between Qualico and Principal Group at the time that Qualico would be allowed to payout the AHL agreement for sale in full and thereby receive title to lands. This was an accommodation of Qualico's request. The balance of the payment was to have been distributed on a pro rata basis among FIC, AIC and CSL. CSL accepted its pro rata share of approximately $1,200,000 and then assigned its agreement for sale to FIC and AIC in consideration of $1,695,840 cash. Consequently, CSL was paid in full while FIC and AIC (after purchase of the CSL agreement for sale) received only 16% of the principal and interest owed. The assignment was effected by indenture dated June 25, 1986, which was executed on behalf of CSL by James Cormie and Pearce, and on behalf of FIC and AIC by Marlin and Patrick. [Exhibit 342] As of June, 1987, the amounts due under the agreements for sale were still receivable by FIC and AIC from Qualico. [Pearce, 8423]

Pearce testified that in late 1985 Qualico advised that it would not be in a position to pay in full the amounts due on the agreements for sale. These amounts were due on April 1, 1986. It wished to renegotiate the terms of the agreements. Accordingly, on April 1, 1986 Qualico was in default. Pearce said that Donald Cormie instructed him to re-negotiate the deal so as to ensure that CSL was paid out in full and that allocation of the payment among the companies was under Donald Cormie's direction. [8016-29]

During the negotiations, Pearce was advised by Johnson that the CSL agreement for sale was assigned as security for the PGL promissory notes. Upon taking the matter up with Donald Cormie, Pearce was told that the assignment was no longer operable because the conditions under which the assignment was required had been met.

Petracca testified that she was not involved in the transaction but was being told what was happening by Pearce and Donald Cormie. [11300]

Marlin testified that he had not realized that FIC and AIC were to be paid only after full payment to CSL. [12202-6] He said that he understood from Pearce that FIC, AIC and CSL were to share pro rata, and that when he signed the documentation, his understanding from Pearce was that the money was to go proportionately to each of the companies. Later he said that he could not say whether Pearce explained all the documents to him and could not recall the contents of any explanation. Marlin said he did not read these agreements before he signed them. [12202-6; 12495-505; 13017-9]

There was a letter agreement styled from CSL to FIC and AIC setting out a proposal whereby FIC and AIC would acquire CSL's interest in its agreement for sale. [Exhibit 342] It is signed by Pearce (on behalf of CSL) but not by FIC or AIC. Pearce could not recall if FIC and AIC had signed it. Marlin said he had never seen it before. [12500; 8027]

James Cormie testified [14367-79] that Qualico wanted to pay out the CSL and AHL properties. Qualico then inquired whether the transaction could be restructured so as to avoid having the CSL agreement paid out in its entirety, since to do so would allow a second charge held by a company called Batoni/Ruma to move into a first position. As a result, the transaction was internally structured to accommodate Qualico's request, and CSL was paid out. Characteristic of Donald Cormie's and James Cormie's attempts to distance themselves from FIC and AIC, James Cormie said that it was Green, the mortgage manager of PGL, who acted for FIC and AIC on this transaction.

Donald Cormie also testified [17661-76] that AHL and CSL were to be the first payouts. He did not agree that only AHL was to be paid out in full, the balance being distributed pro rata among the investment contract companies and CSL. The proposition that it did not matter to Qualico whether CSL's indebtedness was paid down in full or not was put to Donald Cormie, who testified that he did not know. He agreed that his instruction to Pearce was that CSL be paid in full. He testified that by doing the deal this way, Qualico was able to take priority over Batoni/Ruma.

Donald Cormie testified that by having FIC and AIC take the balance of the agreement for sale owned by CSL, they received 124 acres of land as additional security. James Cormie testified that FIC and AIC suffered no harm because they received additional security. [14375-6; 15436-7]

I note that there is no evidence that PGL ever replaced Qualico's debt owed to CSL as the security backing the promissory note due to FIC with anything of equivalent value — or at all. Thus there is evidence tending to show that FIC indeed suffered harm through the loss of some of the security backing $4,200,000 of promissory notes owing to it from PGL, its insolvent parent.

As to the assignment, Donald Cormie testified [22188-98] that in the 1970s there was a verbal agreement between PGL and CSL that CSL would allow PGL to utilize CSL's equity in the Speedway Lands agreement for sale as security for certain promissory notes issued to FIC until such time as the agreement "was to be paid out". The promissory note had been made in favour of FIC as a "capital" injection.

The nature of this transaction is outlined in the audit working papers for the year ended 1986, which reflect discussions with Pearce. The working paper [Exhibit 342] states:

> The agreements came due in '86 and Qualico offered the following:
>
> 1. buy out the AHL agreement
> 2. purchase the CSL, AIC, FIC agreements for cash of $4.6 million and notes equal to the remaining balance
> 3. the notes would be secured by the agreements and hence would still have first charges over Batoni Bowlen
>
> The deal was structured so that Qualico could move ahead of the 6.0 M 2nd charge. By using a [numbered company] to buy the agreement, Qualico can essentially foreclose on themselves and essentially squeeze the 2nd charge out of the deal. If they had simply paid or extended the agreement, Batoni's second charge would still be ahead of Qualico.
>
> As a further note, FIC/AIC decided to buy CSL portions.

I accept Pearce's evidence that Qualico wished to pay out the AHL agreement for sale and wished to maintain the others. I accept his evidence that whether CSL was or was not to be paid in full had nothing to do with Qualico.

The numbered company (a nominee of Qualico) purchased the CSL, and FIC and AIC, agreements for sale pursuant to 2 agreements dated June 25, 1986. Under the latter agreements, FIC and AIC were to receive $2,642,094.39 and CSL was to receive $1,067,898 on closing. James Cormie and Marlin signed for FIC and AIC, and Marlin and Pearce signed on behalf of CSL. Marlin did not at this time have signing authority for CSL. [12501; 15432] Under these agreements CSL would receive its pro rata share.

The indenture of June 25, 1986 assigned to FIC and AIC the outstanding debt due from the numbered company on the agreement to CSL in consideration of $1,695,840.

The money paid by Qualico on June 27, 1986 [Exhibit 409 at 788] was attributed to CSL in the amount of $2,862,324, to AHL in the amount of $300,353, to AIC in the amount of $600,176 and to FIC in the amount of $532,759. The aggregate of the amount contained in the indenture and the amount the numbered company agreed to pay to CSL on the closing date is approximately the same as the amount eventually forwarded to CSL on June 27, 1986.

While there can be little doubt that Qualico wished to have the numbered company buy the agreements for sale in order to prevent the Batoni charge from moving ahead of Qualico, the entire deal was structured on the Principal side through the indenture to enable CSL to be paid out in full. It had nothing to do with Qualico. This transaction is evidence tending to show conduct which unfairly prejudiced the interests of FIC and AIC. In order to advance the interests of CSL, Donald Cormie and James Cormie subordinated the interests of FIC and AIC.

The evidence tends to show that Marlin also failed in his duties to FIC and AIC by signing these agreements without reading them. There is no evidence that the nature of the transaction was misrepresented to him, and the other participants may well have assumed he understood what was to occur.

TRANSACTION #18

On July 4, 1986 the British Columbia regulators demanded that capital be injected into FIC and AIC. On August 26, 1986 PGL issued secured promissory notes in the amounts of $1,683,000 to AIC and $9,567,649 to FIC. Both bore interest at prime plus 2½% per annum. FIC and AIC issued promissory notes back to PGL in the same amounts which were subordinate to the claims of the other creditors, and which also bore interest. [Exhibit 291] The transaction involved what were called in the evidence "back-to-back notes". The British Columbia regulators accepted the transaction as a sufficient capital injection. [Smith, 34685; Ross, 36657]

The notes issued by PGL were collaterally secured by the equity in certain mutual fund holdings. Mutual fund holdings owned by PGL, AHL and EL&F were included in the security package. Those funds had been purchased on margin and were therefore subject to a prior charge in favour of Merrill Lynch Canada Inc., a brokerage firm. According to the assignment documentation, the equity in the collateral as at the time the notes were made was for FIC $10,293,159 and for AIC $1,833,520. The British Columbia regulator, Smith, testified that he was not aware that the collateral was subject to a prior charge. [34720-1] Wooldridge testified that he was not impressed with the security; it was virtually 100% margined. [25055-8] As at March 31, 1987 [Exhibit 499] the net equity on the funds pledged as collateral for the FIC note was approximately $13,500,000; for AIC, the net equity was approximately $2,600,000.

The AIC note was paid in May, 1987. The FIC note was paid in July, 1987 on the demand of Coopers & Lybrand Limited. James Cormie said that PGL planned to pay it out in August, 1987 in any case. [14413-4; 14961; 15020-1] The notes were paid off in full with interest. [Johnson, 6596]

Marlin testified [37210-2] that at the time he understood that the mutual funds were pledged in the first instance to Merrill Lynch, but were owned by PGL.

Donald Cormie testified [17695-712] that CSI and EL&F consented to their equity being pledged by PGL under this proposal and that he would have told Marlin.

The question is, who owned the mutual funds? The funds pledged to support the AIC note were owned by CSI and the account was located at Levesque. [14414] The funds supporting the FIC subordinated note were in an EL&F margin account at Merrill Lynch. Some of these mutual funds were owned by PGL. Some were owned by EL&F. The balance were owned either by CSI or AHL. Stefanski listed the owner of the funds as AHL, but showed advances from Merrill Lynch on those funds to CSI. James Cormie said that was a mistake and CSI was the actual beneficial holder. [13821] Stefanski testified that the shares belonged to AHL and that AHL allowed CSI to utilize its mutual funds as security. [15716] Johnson testified that they were AHL funds. [6592-5] James Cormie earlier had put to him the proposition that AHL owned the funds and raised no exception to it. [14405] I do not therefore find his evidence on this point of much weight. I find as a fact that the funds were owned by AHL.

There is evidence in this tending to show unfair conduct in relation to FIC and AIC. The assets of AHL were to support the value of the millions of dollars of AHL preferred shares owned by FIC and AIC. As noted in respect of Transaction #3, the reason for AHL's involvement was to facilitate the transaction because AIC and FIC could not acquire the assets purchased from Allarco Group Ltd. ("AGL") directly. However, the evidence tends to show that after completion of that transaction AHL continued, at the instance of Donald Cormie, to operate as if it were a subsidiary of CSL. It was in law such a subsidiary. But having regard to the purpose of AHL's involvement in Transaction #3, and the fact that management never suggested that the purpose of Transaction #3 was to transfer the assets acquired from AGL to the purview of CSL, it is unfair that AHL not be operated without scrupulous fairness and unerring loyalty to FIC and AIC. Yet here, AHL's assets are put to use to help prop up FIC. It is, the evidence tends to show, another example of Group assets being placed where needed to defend whatever front was immediately under attack. The evidence tends to show that the strategy often proceeded without regard to the interests of the corporations and their creditors.

As an aside, based on Exhibit 499, EL&F had 7 margin accounts at Merrill Lynch. There were 3 Canadian dollar stock accounts, 3 U.S. dollar stock accounts and 1 mutual fund account. The mutual funds in that account were owned by PGL, EL&F and AHL, although on Merrill Lynch's books they were shown as all owned by EL&F. PGL's equity in the fund accounts was, as at March 31, 1987, supporting deficiencies in the fund accounts of EL&F (by a small amount) and CSI (by approximately $1,400,000). On that point, Muriel Meier of Merrill Lynch Canada Inc. confirmed that in effect the 7 accounts were cross-collateralized and that Merrill Lynch considered that it had, and did have, the right to combine all of the accounts when calculating margin loan deficiencies. As a result, the security pledged to the subordinated promissory notes was at risk for, or would benefit from, as the case may be, not only fluctuations in the fund account but also fluctuations in the Canadian dollar and U.S. dollar stock accounts managed by EL&F (that is, Donald Cormie).

TRANSACTION #20

FIC, AIC and PS&T lent money to a borrower on the security of Okanagan Park Resort in Kelowna, B.C. The resort consisted of condominium units plus a common area with recreational facilities and the like. As security, FIC, AIC and PS&T held mortgages on 48 condominium units as well as a second charge behind the Northland Bank on the common area. The Principal Group loans were in default. Principal Group decided to acquire the Northland Bank's debenture and related securities and take control of the whole resort for the purposes of working out the loan.

As structured, FIC, AIC and PS&T were to purchase the debenture from 321635 Alberta Ltd. (described in Transaction #14, *supra*, and herein called "321635") for $5,100,000 cash. The debenture was to have been acquired by 321635 from the Northland Bank's liquidator for $1,500,000.

If all went according to plan, having sold the debenture 321635 would be in possession of net proceeds of $3,600,000. Obviously it was not entitled to keep them. Rather, it would use the $3,600,000 to purchase from the Principal companies certain owned (i.e., foreclosed) properties with a book value of $3,362,000. The consideration was to be $6,862,000, payable by $3,500,000 in cash and a $3,362,000 vendor takeback mortgage.

The debenture would be recorded on the books at $5,100,000 and a $3,500,000 gain on the sale of the properties would be recorded. 321635 was to earn a commission of $100,000 for its trouble and after it paid the cash on the properties, there would be $100,000 left over for this purpose. [Exhibit 374]

Petracca testified that she proceeded with this transaction without approval from any other person in the Principal organization and she needed no higher authority to proceed. [10422] Donald Cormie discussed the matter with her and was kept informed. [17733-40]

Coopers & Lybrand, an accounting firm advised Petracca that the external auditors would not accept the increase in the value of the debenture. The transaction (already documented and signed) was abandoned in early March, 1987 and in any event prior to March 5, 1987. In its place, FIC, AIC and PS&T purchased the debenture for $1,500,000 in cash. 321635 received $10,000. [Exhibit 373 at F137]

When the transaction was completed 321635 acquired from Northland Bank, effective December 31, 1986, certain instruments of security and evidences of indebtedness in relation to loans made by Northland Bank to Lake Resort Financial Services Ltd. ("LRFS"). These included the debenture, a hypothecation by LRFS of shares in the capital stock of its wholly-owned subsidiary, Lake Okanagan Resort Ltd. ("LOR"), and hypothecations of the shares of LRFS. FIC, AIC and PS&T acquired the securities from 321635. Other agreements were executed with the various companies and individuals involved, and in particular by agreement effective January 31, 1987 all of the issued and outstanding shares of LRFS were acquired by FIC and AIC. That enabled the Principal Group to acquire control of LOR, which was stated in the agreement to be a nominee owner of the assets for the Lake Okanagan Resort Partnership.

FIC, AIC and PS&T had a fixed and floating charge debenture granted by LRFS and LOR, with the fixed charge being against the 48 condominiums. As collateral security, the companies had a pledge of the shares of LOR, which were owned by LRFS. [Exhibit 637] Accordingly, it would appear that the acquisition of the debenture was simply the exercise of the equity of redemption by a subsequent security holder, and that the transfer of shares of LOR by LRFS was an enforcement of collateral security. Taking a pledge of shares is authorized by s. 100 of the *CBICA*.

About the only asset in the piece over which the Principal Group did not have security, but the Northland Bank did, was the shares of LRFS. It would appear that the only asset owned by LRFS was the shares of LOR, which owned the resort. The purchase of the LRFS shares appears to be a short form method of realizing upon the share hypothecation relating to the LOR shares which the Principal Group held. There is in this evidence tending to show in the case of FIC and AIC a violation of the law, but a highly technical violation. Under s. 86(i) of the *CBICA* the company may invest its funds in bonds, debentures, and so on, fully secured by a mortgage, charge or hypothec or upon any combination of real estate or leaseholds, plant or equipment. Under s. 99(l)(d) the company may also invest its funds in the fully paid shares of any corporation incorporated to acquire, hold, maintain, improve, lease or manage real estate or leaseholds. Finally, s. 100 provides as follows:

> 66. Any company may take any additional securities of any nature further to secure the repayment to the company of any loan or investment, or further to secure the sufficiency of any of the securities in or upon which such company is by this Act authorized to invest or lend any of its funds.

Petracca testified that external legal counsel assisted in developing the strategy to work out the loan [10643] and that she assumed that if there was a problem counsel would advise her. She testified that counsel suggested that acquiring the shares was the best means to realize on the security since it avoided the British Columbia real property transfer taxes, and that she relied on him that that was the legal way to proceed. I accept her evidence on this point. Marlin also testified [13028-30] that he assumed that the outside legal counsel who put the deal together would have advised if it was improper. From a legal perspective, the evidence tends to show that Petracca did not act improperly.

Having acquired the debenture and related securities, Petracca embarked on a program to acquire all other condominium units in the resort. There is no evidence that she relied on legal counsel for this aspect of the transaction; however, owing to the complex ownership of the various pieces of the resort and the coverage of the security I refrain from commenting on whether there is evidence tending to show the legal position of this aspect of the transaction. By fluke or otherwise, some of the acquisitions might be said to be the exercise of some security that Principal Group had. I wish to note only that the purchase of these units was necessary to obtain control of the resort. The divided ownership of the resort was the risk that Fuhr said was the reason he would have preferred that the loan not be made in the first place; however, as discussed elsewhere, Donald Cormie and James Cormie wanted these kinds of high risk loans made to earn a return (at least on paper) on the money. This is a good example of the risk materializing.

The transaction, as structured but not carried out owing to the accounting advice of Coopers & Lybrand, is evidence tending to show the overall strategy to cover up losses, in this case, by transferring owned properties to 321635 at an inflated value. Petracca structured the transaction, with the full knowledge and concurrence of Donald Cormie.

EXPERT EVIDENCE CONCERNING CERTAIN SIGNIFICANT TRANSACTIONS

In addition to the evidence described above, some expert evidence was given regarding the effect of these transactions. As I am obliged to deal with both evidence tending to prove and disprove matters within my mandate, I shall now deal with this expert evidence.

The significant transactions, 20 in number, resulted in large cash movements which Barefoot calculated as follows:

	Transaction #	FIC	AIC	$ Total FIC/AIC	PS&T	PGL	AHL	CSI (3)	CSL (3)
Sale of properties by PS&T to FIC and AIC	1	(22,553,655)	(691,474)	(23,245,129)	23,245,129				
Loan to FIC (1)	1	11,300,000		11,300,000		(11,300,000)			
Fee paid by PS&T to FIC	1	840,000		840,000	(840,000)				
Acquisition of PGL preferred shares (2)	2								
Partial payment for AHL preferred shares	3	(12,626,000)	(2,574,000)	(15,200,000)					
Loan to 314986 (including sinking fund deposit)	3	(2,000,000)		(2,000,000)					
Sale of 318939 Alberta Ltd.	4	80	20	100		(100)			
Elimination of debt owed by 314986	4	32,000	8,000	40,000		(40,000)			
Mortgage granted to General Equities on purchase of Norscott Mall	5	(6,080,250)		(6,080,250)					
Downpayment on properties purchased by General Equities	5	456,500	164,000	620,500	608,000				
Payment of levies and subordinated note interest (1984 and 1985)	7	(8,535,000)	(2,255,000)	(10,790,000)		10,790,000			
Sale of Matrix shares to East/West and Hunter	10	7,500,000		7,500,000		2,500,000			
Margin loans by FIC on acquisition of mutual funds	10	(18,000,000)		(18,000,000)					
Payment of 1986 levies and subordinated note interest (net of $1,200,000 repaid to FIC in cash in 1987)	13	(3,898,786)	(1,659,804)	(5,558,590)		5,558,590			

	Transaction #	FIC	AIC	$ Total FIC/AIC	PS&T	PGL	AHL	CSI (3)	CSL (3)
Acquisition of Derrick Plaza....	14				(2,580,000)				
Acquisition by FIC and AIC of CSL Agreement for Sale............	15	(1,695,840)		(1,695,840)					1,695,840
Purchase of Matrix shares through Levesque Beaubien by AHL (net of commissions of $4,500) (4) ...	16					8,000,000		(8,000,000)	
Purchase of PGL Matrix shares by CSI (net of commissions and spread of $377,504) (4)....	17					7,995,499		(8,365,954)	
Balance of funds owing by PS&T on mortgage and owned property sale after reversal (5)......	19	(436,855)		(436,855)		436,855			
Acquisition of Northland debenture on Okanagan Park Resort (based on a purchase price of $1,500,000 plus commission of $10,000)	20	(634,200)	(241,600)	(875,800)	(634,200)				
		(56,332,006)	(7,249,858)	(63,581,864)	19,798,929	23,940,844	—	(16,365,954)	1,695,840

NOTES:

1. At the demand of the Alberta regulators and bearing interest.
2. The schedule in the evidence showed $2,139,000 paid to AHL and $2,139,000 paid by CSL, on the assumption that it was related to Transaction #2. In fact, only $12,500,000 was loaned by PGL for the purchase of its own preferred shares by AHL. The $2,139,000 had been outstanding since at least December 31, 1983. [Exhibit 426 at 22, 126 to 131]
3. This schedule does not reflect "roll over" of assets from CSL to CSI.
4. These figures are shown on the schedule in evidence as received by PGL and therefore have been reproduced in this fashion. While true, the same amounts were advanced by PGL to CSI for the purposes of the transactions and therefore, the net cash flow in this case for both PGL and CSI is neutral.
5. As noted earlier, FIC paid over $9,000,000 to PS&T. The transaction was reversed in June, 1987. The above figure reflects the effect of the reversal. The schedule in evidence shows the net amount as received by PGL, although the trans action was consummated with PS&T. Exhibit 611 suggests that the sum is due from PS&T. The true identity of the recipient of the $436,855, whether PS&T or PGL, does not affect my analysis.

[SOURCE: Exhibit 606, Appendix 3]

The table shows quite clearly the amounts of money expended by FIC and AIC after February, 1984 in transactions which I have found, except Transactions #6, #15 and #18, to be evidence tending to show attempts to avoid or hide write downs and losses, or to create fictitious gains or to avoid regulatory criticism of asset portfolios. I have shown in respect of Transaction #1 the $11,300,000 loan to FIC as a reduction of cash expended because that is what in fact happened; however, as I found earlier, PGL did not intend to pay voluntarily money to FIC as compensation when the transaction was executed but rather PGL was forced to pay it.

In a separate schedule [Exhibit 606, Appendix 3], Barefoot summarized the accounting effect of and the gains and losses precluded by the 20 significant transactions. The schedule is summarized as follows:

($)

	AIC	FIC	TOTAL FIC/AIC	PS&T	PGL	AHL
Gain (losses) recognized in the books	4,848,085	22,997,603	27,845,688	7,811,201	31,497,884	2,951,602
(Gains) losses precluded by the transactions	5,721,683	21,316,853	27,038,536	11,504,717	(87,500)	--
TOTAL	10,569,768	44,314,456	54,884,274	19,315,913	31,410,384	2,951,602

The bulk of the gains recognized by FIC and AIC consisted of forgiveness of levies and sub ordinated note interest for the years 1984 and 1985, the gains on the disposition of Matrix shares in Transactions #10 and #11, and the gain recognized in Transaction #3. The losses avoided are attributable to Transactions #3 ($16,546,853), #4 ($7,970,615) and #5 ($2,521,068). In the case of PGL, the gains consisted mainly of sales of PNI and Matrix shares: Transactions #7, #9, #10, #12, #16 and #17. I have already noted that the evidence tends to show that these gains were fictitious or, at best, speculative (because it could not be known whether the gain would be realized for some years).

This evidence also tends to show the true purpose of the transactions.

Schenkelberg summarized the benefits and costs to the members of the Group. [Exhibit 611 at 75] His schedule is summarized as follows:

	PGL	PS&T	CSL	CSI	AIC, FIC and AHL	OUTSIDERS
Benefit (Cost)	(9,577,631)	4,180,857	(537,383)	(18,809,375)	31,777,633	(7,034,101)

It should be noted at the outset that Schenkelberg's evidence was that his characterization of a transaction as producing a "benefit" was not meant to indicate that the transaction was in fact prudent or desirable. [35962-3] The schedule attributes values to assets (based mostly on the evidence before me) and calculates corresponding arithmetic costs and benefits. [Exhibit 611, Appendix 8] Schenkelberg treated AHL, for the purposes of his analysis, as a subsidiary of FIC and AIC. While the assumption might be valid on the basis that the common shares of AHL owned by CSL became worthless once the preferred shares were issued to FIC and AIC, it must be noted that FIC and AIC did not control AHL and did not have the ability, through common share ownership, to acquire control.

The loss to outsiders was allocated mostly to what Schenkelberg considered to be a loss to AGL in Transaction #3 of $7,369,000. That was based on estimates of the value of the assets involved having regard to valuation material in evidence. Combined with the dilution of CSL's common shareholdings in AHL, it was said that FIC, AIC and AHL benefitted by $7,869,000. I do not accept that FIC, AIC and AHL benefitted to the extent of $7,869,000 through Transaction #3, because as I have found above, the value was locked in AHL preferred shares with limited retractability features and thus could not be realized except over 10 years even assuming AHL had the resources to honour a call to retract the shares (which it did not), and secondly, the assets were in AHL's control, which means Donald Cormie's control. Thus, it is not known if the value would be fully realized and indeed, through Transaction #8 the value eroded. In addition, there was the loss in liquidity and earning power all as described earlier in my Report respecting Transaction #3.

A benefit to FIC and AIC was said to be $7,340,000 after the "capital" injection in Transaction #1, having regard to Touche Ross & Co. estimates of the exposure to loss. Choosing the valuations of CDIC or the Superintendent of Insurance would decrease or eliminate the benefit. Choosing CDIC's figure (the middle figure) as Schenkelberg pointed out [Exhibit 611, Appendix 8], would reduce the benefit to about $5,000,000. It is easy to see that by year end 1984, since FIC did not receive the $11,300,000 for 8½ months after the transaction, the so-called benefit was practically eliminated. I do not accept that there was an arithmetic benefit to FIC on this transaction. Whatever the mortgages and properties were worth, they were non-earning. There was a real and substantial loss to FIC. I have described all of this in Transaction #1, *supra*.

Transaction #8 was, arithmetically speaking, a $1,515,191 benefit to AHL. [Exhibit 611, Appendix 8] It was not a real benefit. AHL simply sold a hard asset, the Northwest International Bank and Trust Company. In return, it settled an intercorporate debt due to CSL, most of which was incurred on the purchase of worthless PGL preferred shares. It also received an unsecured promissory note from CSL. I have stated my reasons for this conclusion earlier.

Transaction #4 was said to be of benefit in the amount of $6,347,847. It was, however, no real benefit. The increase in assets attributed to AHL was supported in the main by PGL promissory notes aggregating in excess of $14,000,000. They were issued at a time when, the evidence tends to show, PGL was insolvent, and since Donald Cormie was indirectly the majority owner and directly the President of both PGL and AHL there was no hope of calling the notes unless he desired it. Transaction #9, acquisition of PNI shares, replaced the worthless PGL notes with some publicly traded stock. The benefit of Transaction #9 therefore, assessed by Schenkelberg on Transaction #4, is $6,347,847. The dividend yield on the shares was low and realization of the benefit could only occur through liquidation of the stocks on the Toronto Stock Exchange (which never occurred). As well, FIC and AIC nevertheless continued to hold related party assets. They were however, better assets.

Transaction #18 was said to be beneficial in the amount of $11,250,649. FIC and AIC eventually received $11,250,649 from their parent; AIC in May, 1987 and FIC after its failure at the instance of Coopers & Lybrand Limited. In the interim, FIC and AIC did not receive cash which they could put to use in earning a return. As I have noted earlier, there is evidence tending to show that AHL's assets were included in the mutual fund security package. As well, while the security was ultimately realized in full, it was highly margined and therefore there was risk of non-payment. Arithmetically speaking, the benefit existed.

Was Transaction #10 of benefit? The computed arithmetic benefit to FIC was $7,500,000, representing the downpayments on the Matrix loans — all of which downpayments were funded by CSI. To FIC it was a benefit. To Principal Group, it was simply funded either from PGL noteholders, or from PGL "downstairs" resources mostly provided by FIC and AIC in the first place. The transaction was, as I have concluded earlier, evidence tending to show a design to hide losses — I cannot characterize as "beneficial" a transaction of such design, especially when Principal Group resources were put to use for such ends instead of legitimate business ends and when the borrower was not at risk, ensuring that CSI (and thus PGL through the intercorporate account) was at risk.

Any "benefits" simply represented a reallocation of cash received in the first instance from FIC, AIC and PGL noteholders. These uses of funds were not prudent.

Comment must be made on Transaction #7. Considering Matrix shares to be worth 19.725¢ each, Schenkelberg concluded that FIC and AIC (through AHL) suffered a detriment of $5,939,405 (19,618,181 x (.50 — .19725)). However, that is simply an over-statement of assets and income. In real terms, the question is whether the administrative services were provided at fair value in the first instance. If they were then, whatever is said about its effect on the financial statements, the forgiveness is a gift, although perhaps made for dubious motives. Barefoot concluded, assuming a 25¢ per share value for Matrix shares for illustrative purposes and based on a 15% mark-up of the cost of providing the services, that FIC and AIC made overpayments (and in 1986 an underpayment) on services in the amounts of:

1986	1985	1984
$(422,800)	$1,442,700	$2,958,900

[Exhibit 606, Appendix 2 (being a calculated sum: 70% of the excess or shortfall for the years 1984 through 1986)]

Schenkelberg and Allan also analyzed the matter. [Exhibit 611, Appendices 6 and 7] By allocating the costs of PGL and PCL to the operations of FIC and AIC based on discussions with former PGL staff, they derived both a minimum and maximum return to PGL from the fees. Their analysis recognized the waivers of fees. The following table adds back the waivers and deletes interest imputed on the promissory notes due from FIC and AIC. That interest was imputed on the net amount of "capital" injected into FIC and AIC; however, had the capital been in the form of shares, the financial condition of FIC and AIC would have precluded the payment of dividends from 1983 onward. Giving the benefit of the doubt to FIC and AIC, it is assumed a dividend could have been paid in 1982 and therefore imputed interest is not deleted for that year. The table shows:

Maximum Return	Dec 31/82	Dec 31/83	Dec 31/84	Dec 31/85	Dec 31/86	June 30/87	Total
Net from AIC	$ 2,287,623	$ 1,594,963	$ 1,800,373	$ 2,217,150	$ 3,170,007	$ 1,320,772	$ 12,390,888
Net from FIC	9,060,113	3,262,098	7,138,988	6,565,351	4,306,022	7,040,596	37,373,168
Costs:							
PGL expenses (min.)	(2,356,364)	(2,317,619)	(2,432,565)	(2,495,042)	(3,205,846)	(1,943,739)	(14,751,175)
PCL expenses	(1,977,349)	(1,549,736)	(3,102,565)	(3,208,096)	(2,413,152)	(2,281,489)	(14,532,386)
Imputed interest	(966,150)	(513,660)	(2,096,000)	(2,089,800)	(2,075,400)	(1,008,754)	(8,749,764)
Levies reversed, but not refunded (1)					5,558,590		5,558,590
	$ 6,047,874	$ 476,046	$ 1,308,231	$ 989,564	$ 5,340,221	$ 3,127,387	$ 17,289,322
Add Back:							
Waived amounts (2)		2,065,268	3,639,380	6,810,374	1,200,000	--	13,715,022
Imputed interest		513,660	2,096,000	2,089,800	2,075,400	1,008,754	7,783,614
TOTAL	$ 6,047,874	$ 3,054,974	$ 7,043,611	$ 9,899,738	$ 8,615,621	$ 4,136,141	$ 38,787,958

Minimum Return	Dec 31/82	Dec 31/83	Dec 31/84	Dec 31/85	Dec 31/86	June 30/87	Total
Net from AIC	2,287,623	1,594,963	1,800,373	2,217,150	3,170,007	1,320,772	12,390,888
Net from FIC	9,060,113	3,262,098	7,138,988	6,565,351	4,306,022	7,040,596	37,373,168
Costs:							
PGL expenses (min.)	(3,068,202)	(2,939,510)	(3,033,783)	(3,168,673)	(4,125,368)	(2,641,760)	(18,977,296)
PCL expenses	(1,977,349)	(1,549,736)	(3,102,565)	(3,208,096)	(2,413,152)	(2,281,489)	(14,532,386)
Imputed interest	(966,150)	(513,660)	(2,096,000)	(2,089,800)	(2,075,400)	(1,008,754)	(8,749,764)
Levies reversed, but not refunded (1)					5,558,590		5,558,590
Add Back:	$ 5,336,036	$ (145,845)	$ 707,013	$ 315,933	$ 4,420,699	$ 2,429,365	$ 13,063,201
Waived amounts (2)		2,065,268	3,639,380	6,810,374	1,200,000	--	13,715,022
Imputed interest		513,660	2,096,000	2,089,800	2,075,400	1,008,754	7,783,614
TOTAL	$ 5,336,036	$ 2,433,083	$ 6,442,393	$ 9,216,107	$ 7,696,099	$ 3,438,119	$ 34,561,837

NOTES:

This schedule may contain $1 rounding errors as Exhibit 611 at 49-50 had been prepared using computer software which truncates numbers rather than rounding to the nearest whole number.

(1) This figure consists of the net amounts of levies and interest waived for the year ended 1986 less the $1,200,000 repayment to FIC made in 1987. Since AHL is treated as a subsidiary of FIC and AIC, the repayment to AIC for the year ended 1986 through the transfer of Matrix shares (Transaction #13) is not shown as refunded. For my purposes, the total amounts paid are valid since only the cash payment has been added back in the subsequent calculation.

(2) Net of payments to FIC and AIC by PGL on subordinated note interest.

Adjusting for receipt of Matrix shares at 19.725¢ each, the overall costs are reduced by $3,869,686 (1984-85) plus $251,843 (1986 — AIC only) yielding $4,121,529. There is a further reduction of $1,200,000 for FIC for the year ended 1986.

Exhibit 623 is a third calculation. For the years 1979 through 1986, it shows total administrative fees received by PGL less total costs (excluding interest costs) to be $14,375,000 ($35,275,000 before waivers).

It would appear that operating costs were less than the fees charged, whether one regards a 15% mark-up as reasonable or whether one allocates the overall expenses to the operations of FIC and AIC. After adjustment for waivers, the overall fees approximated overall expenses, excluding term surplus.

Whichever approach one uses, Transactions #7 and #13 were of no benefit. Using Barefoot's approach, FIC and AIC overpaid some $4,000,000 in fees for the years 1984 and 1985, even before the surplus was paid. Using Collins Barrow's figures, the 1984 and 1985 levies exceeded PGL's maxi mum allocatable expenses by some $2,500,000. Given the value of Matrix shares, the benefit of the waiver was marginal.

The 1986 waiver was also of marginal benefit. While expenses were much closer to the levied amounts, as noted elsewhere, FIC purchased more real estate. The $166,000 gain to AIC was marginal.

I concluded above that the whole matter of waiver of fees was nothing more than evidence tending to show a manipulation of earnings in order to continue the plan to avoid public and regulatory recognition of insolvency for as long as possible. I also concluded elsewhere that the payment of the surplus was not justified. In that sense there was a loss to FIC and AIC, equivalent to the surplus.

Finally, Schenkelberg opined that AHL suffered a detriment of $3,884,792 in Transaction #16. As I concluded in respect of Transaction #16, that detriment depends on the collectibility of the CSL receivable. AHL gave up the receivable from CSL. The detriment either flowed from Transaction #8, from where AHL acquired this receivable, or from this transaction. But this detriment was real.

Thus I conclude that the transactions said to carry arithmetic benefits did not confer real benefits in the overall scheme of things. I also concluded that Barefoot's evidence described in this section is further evidence tending to show an imprudent use of funds by FIC and AIC. The purpose of the use of funds is evidence tending to show that the interests of FIC and AIC security holders were unfairly disregarded. The same is true of Transaction #1 in the case of PGL's security holders: $11,300,000 of promissory note money was lent to FIC on a subordinated basis at a time when, the evidence tends to show, FIC was insolvent.

C. PSML

1. Introduction

As at June 30, 1987, there were offered for sale six Principal Canadian domiciled mutual funds (CMF, PVF, PCF, PGF, PBF and PSF) and two U.S. domiciled open-end investment funds (PEF, PWF). As well, units of Principal Multiplier Fund ("PMF"), a closed-end, unincorporated trust established under a declaration of trust on December 9, 1985 by PS&T, had been offered. Portfolio securities owned by the funds were held for safekeeping by facilities arranged by PS&T or by a Canadian chartered bank. The Canadian Funds were distributed in British Columbia, Alberta, Saskatchewan, Nova Scotia, New Brunswick, Newfoundland and Prince Edward Island through PCL, which derived its distribution rights either directly from the fund or through FIC. In certain cases, FIC had distribution rights to the Fund and in turn had entered into sub-distribution agreements with PCL under which PCL was granted distribution rights. [Exhibits 409 and 435]

PSML was incorporated on February 4, 1976. It was said to have taken over the investment advisor functions previously performed by PS&T [18368] or PGL. [15835-7] It entered into various management agreements with the Funds in 1976 (for CMF, PGF and PVF), 1978 (PBF), 1984 PCF and 1985 (PSF). [Exhibits 409 and 435]

All of the outstanding voting shares of CMF, and the deferred shares of PVF and PCF, were owned by PGL. PS&T acted as trustee on behalf of PGF, PBF and later PSF. PS&T was owned 94.3% by PGL. On that basis, counsel for Donald Cormie submitted that PGL had effective control over each of the mutual funds and could thereby terminate each of the fund management agreements with PSML, if necessary.

Pursuant to the management agreements with the Funds, PSML agreed to provide services in return for a fee. It acted as investment counsel, responsible for furnishing each Fund with recommendations regarding the selection of securities for purchase and sale. It also agreed to provide administrative and accounting services to the various Funds. Each management agreement defines the ambit of investment services, administrative services and accounting services to be provided. Each Fund agreed to pay PSML a maximum of 2% of their net asset value in return for the services. The management agreements, with one exception, provided that PSML and the Fund could terminate the agreement by mutual consent, or as of December 31 provided notice was given before June 30 of the same year. The CMF management agreement, the exception, could be terminated by mutual consent or on 6 months' notice. [Exhibits 409 and 435]

PGL provided the administrative and accounting services to the Funds, although not required by any formal written agreement to do so until July, 1986. Effective July 1, 1986 by written agreement, PGL agreed to provide to PSML certain services, consisting mainly of: administrative services; legal services; the preparation and distribution of financial reports and other information; computer, clerical, payroll, and other office-related services; and marketing and sales strategy development. [Exhibit 270 at 13-14; Exhibit 435] At the same time, by the private account management agreement dated August 14, 1986 [Exhibit 450] PSML agreed to provide to PS&T, FIC and AIC the administrative services, accounting services and advisory services (all as defined in the agreement). The result was that after that date, PGL would not provide investment or advisory services, nor even the administrative services, relating to securities.

A large proportion of the assets managed by PSML were those of the private accounts. [Exhibit 270 at 12] The PSML Preliminary Prospectus (dated in August, 1986 and issued with a view to distributing shares of PSML to the public) [Exhibit 270] represented that PSML managed these accounts and particularized the size of the accounts from December 31, 1981, thereby inferring that PSML had managed the private accounts for some years. The Preliminary Prospectus stated that prior to July 1, 1986 management fees were paid to an "affiliate in consideration of services rendered in connection with the Company's management of such accounts". [Exhibit 270 at 20] In contrast, Donald Cormie's evidence was that PGL performed the investment advisory services for FIC and AIC prior to July, 1986. [17950-1; see also Petracca, 10361-4] The notes to the PSML audited financial statements [Exhibit 330] for the years ended 1982 and 1983 also expressly state that the fees were earned for the management of mutual funds. I find as a fact that PGL — not PSML — did provide the investment advisory services to FIC and AIC prior to July, 1986. The significance of this fact appears below.

PSML was referred to in the testimony as a "flow through" company. PSML did pay certain direct costs. According to James Cormie, they were $400,000 or $500,000 per year. The exact figures [see Exhibit 330] are not material to the matter at hand. The balance of fees was paid to affiliates, namely PGL until August, 1984, and CSL after that date. CSL in turn paid 50% of its fee to PGL, although it was not required to do so. [14500-1] According to the audited financial statements of PSML, the administrative fees paid to PGL (and later CSL) were:

1980 — $1,436,802
1981 — $2,079,595
1982 — $2,059,989
1983 — $3,691,958
1984 — $4,583,292
1985 — $4,675,677
1986 — $3,263,907

PSML's retained earnings during the same period did not exceed $30,000 until 1986, when they grew to $2,156,709.

On August 15, 1984 PSML was transferred from PGL to the parent CSL at book value, $51,485. The transfer was authorized by a PGL directors' resolution signed by Marlin, John Cormie, James Cormie and Donald Cormie. [Exhibit 267] It was then decided that the mutual fund management fee be paid to CSL, instead of PGL; the express reason being that CSL provided most of the actual fund management. CSL was then to pay back to PGL about 50% of the fee (after PSML paid its direct expenses as described above). The payment back to PGL was said to be in recognition of its administrative contribution to the funds. This was to commence effective August 1, 1984. [Exhibit 409 at 588] Notwithstanding the transfer in ownership, PSML figured prominently in the 1985 Annual Review [Exhibit 11] and the 1984 PGL Annual Report. [Exhibit 186]

As a result of the change, the net amount of fees diverted to CSL (and later CSI) from PGL, for the period 1984 through August 4, 1987 was $7,496,904 (of that amount, $3,000,000 was received and recorded as a management fee by CSI between July 29 and August 4, 1987, of which $2,500,000 was then paid to PGL as a reduction of the intercompany account). [Exhibits 426 and 612]

The 50% split in fees continued until July, 1986 when, as noted above, the administrative agreements were changed. This was referred to in the evidence as the "reorganization". With the reorganization, the quantum of the administrative and management fees paid was different than before. Now PGL's fee was based on a percentage of the gross assets that PSML was managing, rather than a split of fee income. This resulted (and Donald Cormie agreed) [17833] in PGL receiving less income than it had when it received 50% of the PSML administrative fee. The remainder was now retained in PSML and not paid in its entirety to CSI.

Both Johnson and Pearce calculated the lost earnings as a result of the reorganization. Johnson calculated and sent to Donald Cormie a schedule dated August 26, 1986 showing the lost earnings to PGL as a result of PSML going public (that is, upon the reorganization, PGL ceased to share the fee with CSL). [Exhibit 270 at 2] The net loss in profit to PGL was $1,665,000. Donald Cormie did not challenge Johnson's figures, but said it was another question whether PGL was entitled to the revenue. Thus he disagreed with Johnson's analysis. [17849-52] Pearce calculated [Exhibit 328 at 219] that the effect of revenues transferred to PSML as a result of the PSML reorganization was a net loss in profit to PGL of $1,561,000. His analysis was along the same lines as that of Johnson.

The reorganization was directed at making PSML a stand alone company for the purposes of issuing PSML shares to the public. The Preliminary Prospectus was filed in the summer of 1986. [Exhibit 270] However, the share issue did not proceed. Some witnesses said that was owing to market conditions [James Cormie, 14519; Pearce, 8052; Donald Cormie, 18414], and others added that the underwriter felt the price of the shares was too high. [Johnson, 6287; Marlin, 12320-3] The long-term plan was said to be to make PGL debt free by using the capital acquired in CSL to pay off the promissory notes owing by PGL to members of the public. The offering proposed in August, 1986 was approximately $40,000,000 of common shares, 50% of which were to be issued by PSML and 50% of which were being sold by the selling shareholder, CSI ("the secondary issue"). The proceeds to PSML, together with an equal amount to be borrowed (from the proceeds received by CSI), would be invested in the mutual funds managed by PSML. Later, the mutual funds could be sold, and as PSML paid its loan back to CSI (CSI having lent the proceeds of the secondary issue to PSML), CSI could then pay PGL and PGL could pay down the notes.

That plan was shelved. Wood Gundy (the underwriters) then proposed a smaller issue of around $20,000,000 at a lower share price, which was turned down by Donald Cormie and James Cormie. [12320-3; 14521-3] There were new discussions in the spring of 1987 concerning a 100% secondary issue (meaning that only the shares owned by CSI would be issued to the public) whereby all of the proceeds would go directly to CSI for pay down to PGL. [17841-9; 18432-37; Exhibit 458]

2. Value of PSML

Donald Cormie in testifying about the transfer of PSML to CSL, was asked whether PGL would sell PSML to a third party for $51,000 or $52,000 in August, 1984. The answer was that, "We would if the flow-through of the cash continued the way it was going, yes". [17798-9]

Earlier he had testified that PSML was a highly desirable vehicle in which the public could invest because it had no capital requirements and no risk. [17789] Donald Cormie said that evidence only applied if it were reorganized. In any case, Donald Cormie did recognize that PSML was worth more than $52,000 in 1984, and that it had potential to be worth substantially more. [17800] He testified as follows:

> Q But the only reason that it was a flow through was because of its decision to pay out the fees it received to CSL and PGL?
>
> A That's right.
>
> Q All right. If it retained that money, it was a very attractive investment vehicle for a public offering?
>
> A Yes.
>
> Q That potential for reorganization, as you put it, simply involved the decision not to pay out the funds it had previously done, not to use it as a flow-through?
>
> A Yes, to reorganize it as a different type, yes.
>
> Q At the time of the transfer at book value . . . that potential was well known to you and the other directors and considered as part and parcel of the transfer, wasn't it?
>
> A Yes, the reorganization would — we hadn't really — yes, that would be correct. It would be known. [17800]

Johnson testified [7614-6] that in mid-1984, having regard to Exhibit 293 at 448A, PSML would be worth around $40,000,000 to $45,000,000 had it kept the fees for itself and not distributed them.

Pearce was of the view that by December 31, 1986 a range of values for PSML in excess of $75,000,000 would be appropriate. [8293-5]

The external auditor McCutchen [24590-3] had established in his mind a value of $20,000,000 for PSML in 1984, for the audit purpose of considering asset coverage in determining the collect ability of the CSL debt. For the purposes of the fiscal year ended December 31, 1985 he estimated a value of between $60,000,000 and $90,000,000 (again for the purpose of considering asset coverage). [24650] Recognizing that half of the revenue continued to go to PGL, McCutchen agreed [24928] that in divesting itself of PSML, PGL had divested itself of a $10,000,000 asset for $52,000.

Schenkelberg valued PSML and PCL together based on 3 times gross mutual fund revenue, which was a formula indicated as applicable by subsequent purchasers of the mutual fund companies in 1987 and also confirmed by a financial advisor to the PGL bankrupt estate. The financial advice came from discussions with individuals at a certain brokerage house with regard to the value in 1983 of a company managing a "basket" of mutual funds totalling some $250,000,000. PSML managed

$250,000,000 of mutual funds in 1983. [Exhibit 270 at 12] His opinion was that PSML and PCL together were worth $15,000,000 as of December 31, 1983 and perhaps as much as $30,000,000. [35928-9; 36041-9] Schenkelberg's valuation was based on a different test than those of the other witnesses. Schenkelberg's opinion therefore may not be comparable to the others.

Senior management placed much higher values on PSML. Marlin believed it to be worth $120,000,000 in early 1986, $140,000,000 in early 1987; and substantially more than book value at the time of the transfer. [12528; 12531] John Cormie testified to a value of $120,000,000 in mid-1986. [9482-3] James Cormie testified to potential values of $324,000,000 and $450,000,000 projected as at December 31, 1988 (analysis prepared June, 1987), and to a value of $120,000,000 in mid-1986. [14532-4; Exhibit 345] Donald Cormie also confirmed a value of $120,000,000 in mid-1986. [18398-401] The senior management believed that PSML was of significant "off-balance sheet" value.

There can be no doubt that at the time of the transfer, PSML was worth substantially in excess of its book value — at least $15,000,000. Donald Cormie maintained that the advisory function had always been CSL's, which advised PSML. As such, the argument goes, PGL would not be prejudiced by the transfer since its only function was and always had been administrative. This statement is patent nonsense.

3. **Structure of PSML**

Pearce testified [8491-5] that PSML's financial strength was related to its management of the mutual funds. The management agreements, which were the source of the fees, required the approval of the unit holders of each of the funds, who were the "many thousands of people that owned them". He believed that the contracts were presented and approved at annual meetings of the funds. Similarly, Patrick testified [8661-3] that in order to modify the fee structure for the management of the funds, it was necessary to convene meetings of the unitholders or shareholders of the mutual funds. The meetings were held and a number of investors attended them.

As to the relationship between voting control and the choice of a fund advisor, Donald Cormie testified that:

> Q The mutual fund ownership is by the fundholders, right?
>
> A Yes. There might be some voting control in some cases that Principal Group might have, but not for the purpose of changing advisors. There's a limitation there. [16668]

Donald Cormie also testified that the shareholders of the funds had to ratify the hiring of PSML:

> . . . your mutual funds have to have a prospectus every year. The shareholders at the annual meeting, if it is a shareholder-type mutual fund, must approve the investment advisor for the following year again. [15840; see also 21902-5]

The value in PSML was due in part to its management contracts, but also derived from other factors. The Preliminary Prospectus purports to be signed by James Cormie and Pearce as officers, and by Donald Cormie and John Cormie on behalf of the board of directors. It describes PSML as one of Canada's leading mutual fund management companies. It points out that the mutual funds are marketed by PCL, in conjunction with other financial products offered by "Principal Group". In this way, "Principal Group" sought to build a loyal client base by satisfying all its clients' financial product requirements from a single source. It is stated in the Preliminary Prospectus that utilization of a dedicated distribution network (both PCL and FIC signed dedication agreements preventing them from distributing funds not managed by PSML [Exhibit 270 at 15]) provided PSML with a competitive advantage because the loyalty of clients of PCL rested with PSML's products rather than with an investment advisor that might promote competitive products. Also, said the Preliminary Prospectus, "since Principal Consultants absorbs all distribution costs, new mutual fund products can be introduced at minimal incremental cost to the company". The Preliminary Prospectus [Exhibit 270] also states:

> The company's five executive officers [Donald Cormie, James Cormie, John Cormie, Pearce and Patrick] have an average of over 14 years' experience in the investment industry. In addition to their current areas of responsibility, most of these executive officers have had considerable exposure to other aspects of Principal Group's operations. This broad exposure is encouraged for all levels of management to enhance the company's flexibility in responding to customer requirements and to assist in the orderly succession of management. [at 22]

In summary, much of PSML's success could be (and was in the Preliminary Prospectus) attributed to the revenue provided through its management contracts with the Funds, its distribution network and its sponsorship by Principal Group. [Exhibit 270 at 5]

Another factor in PSML's success was the management itself; the Preliminary Prospectus stated that:

> The company's investment committee is responsible for developing and implementing the investment philosophy. This committee, which meets weekly, is comprised of the senior members of the investment department together with Messrs. James M. Cormie and Donald M. Cormie, the President and Chairman of the company, respectively. This committee reviews the activities of the past week and develops the investment position for the coming week. The individual portfolio managers then implement this position which is reviewed at the next meeting. The investment committee also reviews individual portfolio performance in light of market movements and to determine whether the investment strategy has been properly implemented. All members of the investment department meet on a daily basis to review market developments in their areas of expertise. Subject to the general investment strategy set down by the investment committee, the portfolio managers have discretion in managing the Funds for which they have responsibility. [Exhibit 270 at 13]

Donald Cormie testified that the investment committee meeting of PGL and the investment committee meeting of PSML was a "joint function" in that it was the same meeting, with the same participants (Donald Cormie, James Cormie and John Cormie). Those participants, he said, always worked for PGL, but were also paid by CSL, which also had an investment committee, consisting of the same people, who just split responsibility. Half of the meeting was for PGL, but the functions were not at all separated. [17852-7] But he said:

> . . . CSI paid these people as well for work that they did for their long-term planning on the CSI. That was considered to be ultimately investment advisory function that would go over into the public company. And the administrative section of it would be retained by Principal Group because it was a joint aspect prior to that. That is, Principal Group provided the trading and the handling and the bookkeeping and everything in conjunction with that committee. [17857]

PSML paid millions of dollars to PGL for this advisory service for years:

> But, at all times, these people going a way back to prior to Principal Group, were being paid by Collective Securities Limited and some of them by Estate Loan & Finance Limited, prior to Principal Group's existence even. And so there was a dual purpose, and I estimated as I explained, about half my time was spent on Principal Group and half my time was spent on the other companies. [17858]

The investment committee met weekly; it was a function of PGL. In 1976 PSML was incorporated to carry on this investment function, but it was the same committee meeting at the same weekly time to provide the same weekly investment services to the same investment funds and corporate portfolios as it had prior to 1976. This same committee carried on through 1987. The advisory function was carried out by PGL until the 1986 reorganization. CSL or CSI had no part in the committee whatsoever and I do not accept Donald Cormie's testimony on this issue.

On August 26, 1986 James Cormie wrote a memorandum stating that to facilitate completion of the public offering of PSML, the company was being restructured, involving the assignment of certain full and part-time staff to PSML. This restructuring would be accommodated through reallocation of the current salaries and benefits from PGL to PSML for such staff members, although there would be no change in the method of payment. The employee list included Donald Cormie, James Cormie, John Cormie, Lynn Patrick, Rob Pearce, numerous members of the investment department and certain of the accounting department, including the accountants for funds and securities. [Exhibit 409 at 617]

Donald Cormie testified in regard to this memorandum that even prior to the 1986 restructuring not all of these people were paid solely by PGL; rather, some would be paid by PGL and those costs would be allocated to other companies. [14509; 17864-6] Prior to July 1, 1986 the executive officers employed by PGL, and the management levy paid to PGL included compensation for these officers. [Exhibit 270 at 22] Allison Cormie was paid by PGL for her cyclical theory work even though that was not an administrative service. [18233-5; 16565-6] In 1985 CSL paid no salaries for the so-called advisors, Donald Cormie, James Cormie and John Cormie. Nor had it paid them salaries in 1983 and 1984. [Exhibit 337 at 68-9] Donald Cormie's evidence was that CSL did not pay them a salary in 1985 because it was decided not to draw them at that level, that payment of salaries from the CSL level was "erratic" over the years, and further that sometimes they might defer the salary rather than draw it. [16603-5] On the other hand, PGL paid them salaries. In John Cormie's case, PS&T paid the salary. [Exhibit 337 at 68-9]

James Cormie's resume traces his employment history beginning as a junior analyst during the summers and part-time during university terms, with PGL. His position was as a securities analyst in 1974 then as a portfolio manager in 1974 through 1976. He became manager of the Stock and Bond Department in 1976 and Vice-President of Investments for PGL in 1978, a position which he held until the bankruptcy of PGL. From February, 1976 to August, 1987 he was also the President and a director of PSML. He was a director and a Vice-President of CSI from its inception until August, 1987. He was a Vice-President of CSI as well as a Vice-President of CSL since 1973 and 1974, and a director. He testified that in the initial years, E&LF paid him. Starting in 1974, he went on the PGL payroll. Starting in June, 1986 his salary was split between PGL and PSML. The Investment Committee, he said, was comprised of John Cormie, Donald Cormie and James Cormie, and the various portfolio managers. [13697-714; Exhibit 409]

I find that CSL was providing no such advisory services. It was PGL which provided them until the 1986 reorganization.

It is necessary to consider PGL and the Principal Group of Companies' public position prior to the transfer in August, 1984.

PSML was always considered the stock and bond investment arm of the Principal Group of Companies and was formed to carry out that function:

> The Investment Department represents the 'money-out' function of Principal. It consists of the Stock and Bond Department and the Mortgage Department. Principal's investment strategy and parameters are set by the Investment Committee, which meets weekly to analyze economic trends, set policy, and verify adherence to policy.
>
> **Stock and Bond Department**
>
> The Stock and Bond Department was re-organized in 1976 under a newly incorporated company, Principal Securities Management Ltd. The new company was set up as a consequence of what Principal felt to be retrograde changes in legislation (The Alberta Trust Companies Act), ...
>
> The Stock and Bond Department has been very aggressive since late 1974. Managing three investment funds and virtually all corporate accounts, the Stock and Bond Department had enjoyed good success over the last year . . . [Exhibit 186, 1976 PGL Annual Report]

James Cormie was listed as Manager of the Stock and Bond Department in 1977. By 1978 he had become Vice-President, Investment Department; by 1979 Vice-President, Investments. James Cormie retained the latter designation through 1986. In the 1985 Annual Review he is referred to as Vice-President, Investments.

In PGL's 1982 Annual Report [Exhibit 186], the Chairman's Perspective, signed by "Donald M. Cormie, Q.C., Chairman and President, Principal Group Ltd." states *inter alia*:

> Principal's growth is the result of four factors: 1) our strategic planning; 2) our management team; 3) experienced investment management; 4) marketing and technological innovation.
>
> • • • • •
>
> We believe in corporate planning based on solid economic research. With Principal's 29 years of experience, we have become leaders in analyzing economic trends and financial markets. Based on our research, we believe we have seen the beginning of a stock market boom of major proportions. This has allowed us to chart a sensible course to best meet our established objectives.
>
> • • • • •
>
> The second factor is our management team. Skilled financial management is one of the cornerstones of Principal's outstanding success. We have been able to blend a team of seasoned veterans with young, highly skilled and aggressive professional managers.
>
> This combination has been extremely effective for both the company and our clients. Two of the top four funds in Canada, out of 168 funds, were Principal Group funds. We are constantly formulating strategies based upon the current economic environment, as well as future trends. Principal's experience and expertise enables us to produce excellent returns for our clients.
>
> • • • • •
>
> Our three stock investment funds have substantially outperformed the Toronto and New York markets over the last eight years. Principal Venture Fund Ltd. [PVF] has increased 521.9 per cent since December 31, 1974. Principal Growth Fund [PGF] and Collective Mutual Fund Ltd. [CMF] have increased 249.8 per cent and 342.3 per cent respectively in the last eight years.
>
> I am extremely proud of our investment performance. I am confident in Principal's ability to capitalize on the stock market boom we see ahead.
>
> • • • • •
>
> In anticipation of the period of unparalleled prosperity we see ahead, we have registered two new mutual funds and three new investment certificates in the United States through our associated companies there. We think it is time to transfer the expertise we have developed here in Canada to the U.S. market. We have refined marketing and investment concepts that are well suited to that market. We are now actively expanding in the largest market in the world.
>
> We are entering what could be one of the most exciting financial decades in history. Our strategy has been carefully constructed. We have built a team of experienced and progressive managers. Principal is poised to capitalize on the opportunities we see ahead for the benefit of our clients as we help them achieve the financial freedom that is so important for their future.

There is no doubt that the investment advice and function was that of PGL and the Principal Group of Companies. PSML was the investment department of the group and it carried out the investment function. The 1979 PGL Annual Report sets out that:

> The Investment department is responsible for the Stock and Bond, and Mortgage Departments. Under James M. Cormie, Vice-President Investments, the department provides investment services for the company's seven corporate portfolios, four investment funds, and other large managed accounts. Investment strategy is set by the Investment Committee, which meets weekly to analyze economic trends, set policy and verify adherence to its policy.
>
> With 25 years of experience in financial markets Investments has acquired particular expertise in analyzing economic cycles as they affect investment markets, forecasting market trends and maintaining a profitable spread with a high degree of liquidity. [Exhibit 186, 1979 Annual Report at 22]

The expertise was PGL's and never CSI's or CSL's.

Even after the transfer, PSML was held out in the 1984 Annual Report and the 1985 Annual Review as a member of the Principal Group and the Investment Management Group. For years before the transfer the Annual Reports of PGL had stated that PS&T was the investment manager, and later, PSML. None of them suggest any involvement on the part of CSL; some of them suggest that the expertise and research is that of PGL. [Exhibit 186: 1978 at 9; 1979 at 3, 11-13, 22; 1980 at 3, 18]

4. Evidence Concerning the Transfer

John Cormie [9579-82] testified that CSI built the business. Donald Cormie, John Cormie and James Cormie built the mutual fund business and where they put it, in terms of their abilities and skills and as shareholders, was their prerogative. While PSML was transferred to CSI, John Cormie said, the value went down to PGL on the collapse, as was fully intended. John Cormie's perception of value was that CSI owed PGL $67,000,000 that had to be satisfied in some fashion. The testimony continued:

> Q So they took this asset out of PGL and put it into CSI, and the asset that was owned by PGL was now going to go public, and the money from that they're going to use to pay back PGL?
>
> A Well, the debt up at the CSI level, which goes right to PGL, yes.
>
> Q Yes. So what we have is PGL owns an asset, another of their assets is a $67 million debt from CSI, so how we're going to solve that is we're going to give this asset to CSI to sell so they can pay it back their money. Isn't that basically what happened?
>
> A You do forget that half the income is still up at CSI. So you wanted to get the project where the income is as well.
>
> Q But the asset, even half of $140 million is quite a bit. So half of the asset was given to CSI so they could pay their debt that wasn't attracting any interest anyway. Now, isn't that what happened? Isn't that what was discussed when you did it?
>
> A Yes. The idea was to set this company in the basis it could be groomed with a clean prospectus and be marketed. That was done with tax considerations, with full advice from pros in the business. [9581-2]

John Cormie's understanding was that PSML was transferred to CSL for the purposes of "grooming" it to become a public company. [9413-4] It was a "due diligence" question [9671], meaning that it would be easier to launch the issue from CSL since it would avoid the requirement of disclosing the operations of PGL and its subsidiaries. [9579-80] His evidence was that the proceeds of the contemplated public offering were to be used to reduce the intercorporate debt between PGL and CSI [9477-9], and thus to pay the noteholders of PGL. [9672-3]

Marlin testified [11740-45; 12313-23; 12916-7; 12924-5] that the purpose of the transfer was tax planning, such that some of the income earned by PSML would be paid to CSL and used to offset tax losses incurred by that company. Marlin understood that until the transfer, CSL had nothing to do with PSML except to the extent it happened to be its grandparent. He also understood that the proceeds of the public issue were to be used to pay down the intercorporate debt between PGL and CSL.

Under cross-examination Marlin stated that when he first heard of PSML going public (early 1986), he believed PSML to be worth $120,000,000. [13635-6] He continued:

> Q How did it get from PGL to CSI?
>
> A It was sold, or moved up at book value to the parent.
>
> Q How much, then, did CSI pay for PSML?
>
> A $52,000, I believe.
>
> Q So, sir, how from August of 1984 to the spring of 1986 does PSML appreciate from $52,000 to $120 million?
>
> A It didn't appreciate that much in that period of time. It was a matter of what value do you move it up at. In order to avoid tax on the sale, if you like, it was moved at book because of the common ownership of the parent. It was moved at book which, I believe, is a reasonable approach.
>
> • • • • •
>
> Q What kind of disclosure was made to the creditors of PGL, the people buying notes in PGL, that an asset valued at roughly, say then, $100 million was being moved out for $52,000?
>
> A I don't believe there was any disclosure made. In my mind, it really hadn't changed from a practical standpoint, the security behind the Principal Group notes. I realize from a legal standpoint it certainly changed it. I didn't really view it that way myself. [13637-8]

He said that even after the transfer, PSML was still available to support the promissory notes. [13638; see also, 12526-8]

James Cormie testified [14497-501; 15095] that the transfer was made on August 15, 1984 at book value for two reasons: first, to remove PSML from the regulated companies; and secondly, to enable the separation of administrative fees and advisory fees. Demarcation of these fees is required in United States securities regulation, said the witness, and might become a requirement in Canada.

The easiest and best way to accomplish the objective, said the witness, was by way of a s. 85 *Income Tax Act* rollover, and then split the fee accordingly. Why this transfer was necessary to "split" the fee in contemplation of securities regulation is unclear since the entire fee was paid to CSL, and thereafter CSL remitted 50% to PGL. [14501-3] Rather, CSL was chosen as the parent for PSML because it appeared to this witness to be a more logical corporate structure. [15095-6] The difficulty with that explanation is that after the 1986 reorganization, CSI received no fees for any advisory function pursuant to any formal agreement and so, James Cormie said, that function was left in PSML with the shareholder, CSI, being the beneficiary. [15097-9]

He testified to an additional reason for the transfer as follows:

> Q In 1984, one of the reasons for taking PSML out of the PGL Limited ownership and into CSL was with a view to grooming it to take it public?
>
> A That's correct, at some point in the future. We had no idea when.
>
> Q At some point in the future, right. With a further view to grooming it to taking it public, it ceased to become a flow-through entity, as such, in June 30th, 1986, right?
>
> A That's correct. [14503]

James Cormie testified that the purpose of taking PSML public was to raise money to pay off the debt of CSI owing to PGL. It did not appear to him, however, that PGL had transferred an asset to its debtor for the purpose of being paid by that debtor because, he explained, there were different reasons for the transfer and for the decision to take PSML public. Upon being asked whether CSI could not repay that debt but for a public offering of PSML shares, he testified that CSI could "possibly" pay that debt and that it was never in question as to the ability for it to repay on any "year-end audited statements". [14524-32; 15118-9]

Donald Cormie gave evidence that PSML was created in 1976 to take over the functions previously performed by the investment department of PGL. [15835-6] PSML was to stay in PGL until such time as PGL recovered its costs that it had put into development of that department. [15836-7; 17810-12] Donald Cormie said [16597-604] that it was always intended that CSL and PSML would provide the fund advisory management. Prior to 1984, the fees were left in PGL in order to cover the administrative costs until he felt those had been recovered. This would recognize PGL's administrative contribution to the Funds. Thereafter, the advisory function was split off to CSL, which was doing the advising. Notwithstanding that, PGL paid all of the salary of Donald Cormie and James Cormie in 1985, and PS&T paid that of John Cormie. [Exhibit 337 at 68] As noted earlier Donald Cormie said they decided not to draw the salaries from the CSL level at that time. [16603-5]

Donald Cormie's evidence on the transfer was as follows:

> Q So in the context of what was being done with PSML to take it public, can you tell us why it was decided to transfer the entity from PGL to Collective Securities Limited in 1984?
>
> A Well, there were several reasons. The main one was a reorganization that we wanted to separate the mutual fund business from the administration business.
>
> We found in the United States that the SEC was taking a strong stand on the companies that the administrative charges to another company from a mutual fund manager could not exceed, to any great extent, the actual layouts or expenses that that administrative company would be providing, and that the investment advisory function couldn't be kind of treated as if it was an administrative fee.
>
> So we were anticipating something similar would probably happen in Canada in due course, so we were anxious to separate the investment advisory function from the administrative function. And since the investment advisory function was only the three Cormies, that was John and Jamie and I, and we had been working with the mutual funds ever since they started, really, it was felt that this was closer to CSI for the administrative function and for the investment advisory function, and that's where the investment advisors were spending more and more of their time. So that was the reason why we decided to transfer it. [17804-6]

The witness agreed that a change in ownership did not change PSML's function, and that the motivation to transfer PSML was founded upon wanting to remove PSML from PGL's ownership. He continued:

> Q You wanted to get it out of PGL or its subsidiaries in terms of ownership to further isolate it from the regulatory environment?
>
> A Well, that might have had some bearing on it. It might have impacted going public in one way or another, but that wasn't something we found out because we actually transferred it.
>
> Q Were you concerned that this was a valuable entity and that there may be problems with PGL or the contract companies in the future, and you wanted to transfer it out so it wouldn't be subject to attack later on?

A No, I would have been more concerned with whether or not the due diligence of going public would have been impacted some way by that relationship, because our intention was to use PSML as the main company to, in effect, make Principal Group debt-free, was the object.

What we were interested in was to be out of the certificate business within three to five years, have Principal Group debt-free, and only manage mutual funds.

Q I understand all that. I think I am obliged to put to you the suggestion that you were transferring a valuable asset out of PGL because you anticipated that PGL may be in some difficulty as early as mid-August 1984.

A No, that was never the case. We never realized that PGL would be in any difficulty until almost the 7th of August 1987.

Q All right. So the factors involved were to isolate it for the purposes of going public, isolate it from the regulatory environment?

A Yes, and to separate the administrative from the investment advisory functions more clearly. [17807-8]

• • • • •

Q But I thought I had already dealt with that.

A Yes.

Q The regulatory reasons, are there any other reasons. You have denied any apprehension of any difficulty.

A Yes.

Q Any other reasons other than regulatory reasons in terms of doing a public issue eventually or otherwise isolating it from a regulatory environment?

A Well, I think it was easier to manage at that level because we didn't have — that is, you could do much more tax planning, I might say, at the CSI level than you could at the PGL level. [17809]

• • • • •

THE INSPECTOR:

Would you follow that up. I don't want to get into this, but I just don't understand why Principal Group would get rid of a company with that kind of income. I heard the only reason was because of some regulatory problems and it had no regulatory problems and it sold it for $50,000. Now, I would like to know what regulatory problems Principal Group Limited had that would cause them to sell an asset with a gross income of $7 million for $50,000.

A Well, whatever the value was, our thought frankly, was not along that line at all. Our thought was that the object of going public is to make Principal Group and all the companies debt-free. We thought that was the best way to do it. [17813]

Donald Cormie was then asked why all of this could not be done with PSML being owned by PGL, and in answer to the suggestion that it could he said, "Yes, but on the reorganization we didn't want that, we wanted the mutual funds separate". The examination continued as follows:

Q All we want to [know] is why didn't you want it?

A Because it was desirable to have the mutual fund operations separate from the other operations.

Q Why?

A Because they are different types of businesses, substantially different. One of them was providing services and had huge staffs and organizations, and the other one was more or less — well, it was an investment advisory business that required skill.

THE INSPECTOR:

But they were separate. One was in PSML and the others were in FIC?

A Well, I guess if you refer to it, I suppose the question at that stage is how does the value get in there? Does it get in there from the three people who are the investment advisors in it, because that's all the company is. How does it get in there? Does it keep the three people? Does it sell the people like they are bags of salt or something? No. It is the skills of the people that ultimately determine the value of that company.

Q MR. WITTMANN: And the three people determine which corporate vehicle can be used.?

A That's quite true, yes. They were in a position to do that.

Q They could have doing [sic] everything that is done with CSL as the owner, with PGL as the owner?

A Not in my opinion. I think it would be much more difficult.

Q Now we're getting somewhere. Your opinion is that they couldn't have done some things with PGL as the owner, right?

A I think it would have been more difficult.

Q What things?

A Particularly due diligence matters.

Q Now, that due diligence matter is the test required when one goes public, right? That's what you are referring to?

A Yes, that's the —

Q On a prospectus?

A M-hm.

Q Just hear me out. There is a prospectus for common shares in PSML that was finally proposed, right?

A Yes.

Q And approved by the Securities Commission?

A Yes.

Q Okay. You were saying that that approval would have been less likely to have happened if PGL was the owner of PSML?

A I am saying that the lawyers and the people that have to do the due diligence and do the certifications might have had a more difficult job doing it if you were dealing from a position as being a sub of Principal Group than you are from dealing as a sister of Principal Group and a sub of the same parent. [17814-6]

• • • • •

Q Give us an example what difficulty they would have had with Principal Group as the owner of PSML instead of CSL.

A In retrospect, it was vital. I mean, what happened, who would have known that would have happened to First and Associated on June 30th. My God, if you had put that in the prospectus, you would have anticipated it, you would have had a nightmare.

Q Not June 30th, '87. We are back in 1986, that's when you did the public offering.

THE INSPECTOR:

1984 is where we are at.

Q Mr. Wittmann: All right, '84 is when the concept was?

A Yes.

Q You didn't anticipate any trouble in PGL. You just told me that.

A We weren't anticipating anything that couldn't be handled, no. We weren't anticipating anything that couldn't be handled.

Q Okay.

A But it is desirable to separate the functions. I think as I indicated, we were looking to try and see if we can take the other group and make it into a public national brokerage house. We didn't want the mutual funds under that, we wanted them separate from that. So our whole reorganization was the idea of separating that function, those functions and those companies.

Q Well, the functions were separate to start with. It is the ownership. All I am talking about now is the ownership of shares in a company which, indirectly, is the same individuals in any event, right?

A Yes, and remember that these are all private companies. So the only point in the question could be, was it prejudicing the creditors. Because the point, really, was to get the company debt-free anyway, from our point of view, so there was nobody involved in it. They are two private companies. And the private companies have to decide where they think the best future is.

Q All we are asking for is the reasons for the decision.

A Well, that was the reason. It was the reorganization, we wanted to separate them, separate the mutual fund completely and have it as a sister operation. [17817-9]

Relating to the transfer in 1984 the witness testified that he thought the due diligence question was much simpler at the CSI level:

THE INSPECTOR:

. . .You say it was one of the reasons you transferred it to the other company was because due diligence would be difficult, and I am asking how could that possibly be?

A Well, it seems very obvious to me. [17821-2]

The explanation that followed was not enlightening.

Management testified that PSML was transferred to CSL from PGL at book value in order to avoid potential tax liability and take advantage of the tax rollover provisions in s. 85 of the *Income Tax Act*. [Donald Cormie, 17871; James Cormie, 14498] The evidence that Donald Cormie considered that matter is not strong. On the subject of electing to transfer the shares under s. 85 of the *Income Tax Act*, Donald Cormie testified:

Q . . . I take it this wasn't considered in August, 1984 before Mr. Johnson's arrival?

A No, I don't remember this being considered. But I assume the tax position would have been reviewed by the Vice President of Finance. [17870]

On his arrival in November, 1984, Johnson took care of the matter. [Exhibit 449] In that regard, Donald Cormie continued:

Q . . . he makes sure the election is taken care of because fair market value may be higher than book value?

A Yes.

Q That didn't occur to the directors that did the transaction at the time?

A Well, they didn't know. Whether they didn't — they didn't dwell that point.

Q I said, did it occur to them?

A Yes, it probably occurred to them, and they decided to proceed the way they did. [17870-1]

Under examination by his own counsel, Donald Cormie testified as follows:

Q Mr. Cormie, it has been inferred at these hearings . . . that you moved PSML from being a sub of Principal Group Limited to a sub of CSL to get the assets away from PGL and its creditors?

A No, that is simply not true. Our whole object was to get PGL debt-free. I mean, everything we wanted to do was to get PGL debt-free.

THE INSPECTOR:

That is what I have a difficulty with. Can you tell me why transferring an asset at base cost, Mr. Cormie, will help make PGL debt-free?

A Well, the reason it was transferred at base cost was because there was no tax consequence doing it at its base cost. If we had attempted to eliminate —

THE INSPECTOR:

We went through that and I understand that. My question was, how does transferring it at that cost help make PGL debt-free?

A Because at that stage, CSI is proposing to start to pick up the obligation for the notes and pay them off. So we were trying to find methods that we could flow the cash to PGL, the tax paid. So by having CSL pick up the proceeds from the sale, pick up the notes, we could then eliminate — Principal Group wouldn't have any tax on the sale of the preferred shares or the common shares.

• • • • •

THE INSPECTOR:

We have PGL owns this company.

A Yes.

THE INSPECTOR:

And you say by transferring it to CSI, it was going to help make PGL debt-free?

A That was our plan, yes.

THE INSPECTOR:

That was your plan, okay.

A Our plan was that we would have the — first of all, the first issue that we proposed publicly, half was a primary going into the company itself, half was a secondary going to CSI. Then CSI would loan its half to the company and it would buy 40 million worth of mutual funds because we saw a good market for a year. At that time, we expected the 40 million was probably worth 50 to 60 million, that 40 million that we got from the public underwriting. Then we could do that one of two ways. We could simply have PSML pay back CSI, and CSI would just use the money to pay the maturing notes as they came due. Now, when we — [18388-90]

• • • • •

Q Mr. Duke: Let me come at it this way. When did you consider taking this company public?

A It was really in late '85 and early '86.

Q So it wasn't at the time of the transfer?

A No, not at the time of the transfer.

THE INSPECTOR:

Okay. Well, that is different from what James and the others have said, but that is fine. But let's get down to this. But he did say the reason it was transferred was to make the company debt-free.

Mr. Duke: No.

THE INSPECTOR:

Did I miss his evidence this morning?

A No, what I said was one of our intentions in the overall reorganization was to get Principal Group debt-free. That was a huge benefit to the whole group. [18392]

Donald Cormie then testified that he moved PSML from PGL to CSL to reorganize the Group in order to separate the mutual fund business from the rest of the business; to segregate the investment advisory function from the administrative function; to make PSML more independent in order to have a better opportunity to bid for third party business. [18393-6; see also 18376-7] His evidence appears to be that PGL was entitled to transfer PSML to CSL to enable CSL to pay PGL on the intercorporate loan because PGL had no right to claim the investment advisory function in the first place. [18391-2; 18410] The plan to make PGL debt free was to be carried out by paying down the intercorporate loan. [18404-6] He also gave evidence that the transfer would strengthen Principal Group. [18408-10]

Under cross-examination he testified:

Q Now, just how can you possibly say to us that Principal Group Limited had no right to this income? It owned the company, it owned PSML.

A Yes, but you don't own the investment advisors.

Q They were threatening to quit, were they?

A No, but the investment advisors could simply form a new company and go ahead and bid on the contracts. [22263]

Under further cross-examination, Donald Cormie maintained that the transfer was done in the best interests of the Group, which he defined as CSI and all its related companies. On this occasion the answer was:

Q . . .Why was it in the best interests of First Investors for Principal Group Limited to give up about $1,200,000 cash revenue for $50,400?

A Because we could make a public company out of it. We had to isolate it away from the other companies slightly to get the third party business which we were looking for, and we were also going to be able to make Principal Group debt-free by that trans action. We were going to take it public. We were drawing the weak assets up to CSI with the debt, with the idea that Principal Group would take those profits, leave the debt. Then as the public issue came, it would retire the debt and we could leave Principal Group debt-free. There was nobody else would be concerned in it and that would have happened — we would have paid every single penny of the notes off if the government hadn't stepped in. [22265-6]

• • • • •

Q Can you just explain to us what happened to PSML between 1984 when it was sold for $50,000, to this time in Toronto [June 2, 1987] when it's now worth $140 million, to so greatly increase its value?

A It was reorganized into a public vehicle.

Q So —

A And the proper contracts put in place.

Q So had Principal Group Limited only waited and not been so anxious to get this $50,400 it, too, could have had the 140 million?

A No, it could not have had it. It was not a suitable place for that company to sit for the purposes of developing it. It had be outside, farther away.

Q Why?

A Because one of the purposes of PSML was to get third party business, and Principal Group was too close.

Q Why?

A Because it's too close.

Q Why?

A You don't get third party business if you've got your competitor sitting right beside you. We had to isolate it more.

Q You thought that if it was at Collective Securities Inc. nobody would notice that it had an association with PGL?

A Well, we talked to people, Mr. White, as to what they would be prepared to accept.

Q It was still in the Principal Group of Companies, wasn't it?

A Yes, it was still in CSI.

Q It was still in the Principal Group of Companies, wasn't it?

A Yes, it was one level up, it was CSI. [22267]

At that point, Donald Cormie's attention was directed to Exhibits 236 at 41 and 11. Exhibit 236 specifically states "Principal Securities Management Ltd., a member of the Principal Group of Companies". As well, pages 18 and 19 of the 31st Annual Review include a section on Principal Securities Management Ltd. The testimony continued:

Q You say, sir, that PSML was put into the hands of CSI to distance it from Principal Group Ltd.

A Yes, that was one of the purposes.

Q Really?

A I didn't say the only purpose.

Q Really?

A That was one of the reasons.

Q Mr. Cormie, was the whole object of moving PSML to get PGL debt-free?

A Yes — no, not the whole object. There were other reasons altogether separate, but that was our objective. We figured the two public issues and Principal Group would be debt-free and there would be nobody concerned about it but ourselves. Now, we didn't anticipate the huge real estate write-downs on the investment contract subs. That was completely unexpected.

THE INSPECTOR:

When was that unexpected?

A We didn't expect the size of the write-downs to hit the companies in 1982, '83 and '84. [22270-1]

Donald Cormie again denied that the whole object of moving PSML was to make PGL debt free, notwithstanding that he had previously testified that the whole object was to get PGL debt free. [18388]

Donald Cormie also testified that they would have moved PSML out of PGL regardless of whether it would make PGL debt free. [22273]

Some mutual fund prospectuses are in evidence. [Exhibit 439] In the case of PVF each mutual fund share is entitled to one vote and each deferred share is entitled to 1,000 votes. Since there were 5,000 deferred shares, PGL had 5,000,000 votes. There were, however, outstanding as at that date, better than 9,600,000 mutual fund shares. According to p. 29 of the prospectus, which shows the number of shares owned by related parties, the only corporation that held shares in PVF was PGL, which held the deferred shares. It also states therein that the directors and senior officers of PVF, as a group, beneficially owned less than 5% of its mutual fund shares. It would seem that, in terms of voting, PGL did not have a voting majority and could not terminate the management contract. The PBF prospectus [Exhibit 439] indicates that the units had no voting rights and there are no directors' or shareholders' meetings. PBF was a trust. In its case, therefore, it would appear that PS&T could terminate the agreement.

5. Conclusion

The argument filed on behalf of the Cormies at vii.126, quotes from page 10 of the commercial copy of the 1987 Canadian Simplified Prospectus offering shares of Principal Equity Fund, Inc. and Principal World Fund, Inc., two U.S. domiciled open-end investment funds. The quotation states that pursuant to an investment advisory contract the investment advisor was responsible for the actual management of the funds' investment portfolio, and pursuant to an administrative services contract the investment advisor provided all administrative services to the funds and further that the investment advisor had subcontracted that to PGL. This is demonstrative of the point that in order to separate the advisory and administrative functions, it was not necessary to transfer the ownership of PSML from PGL to CSL. It was only necessary to put some formal agreements in place. I do not accept that this was a reason.

It seems that the intention to have PSML issue shares to the public was a reason for the transfer. Donald Cormie variously adopted and rejected this reason, while James Cormie and John Cormie testified that it was one of the reasons. I have noted below that taking PSML public would then allow CSL to pay off its debt due to PGL.

Donald Cormie considered that it would be more difficult to do "due diligence" on PSML if it were a subsidiary of PGL rather than a subsidiary of CSL. That is simply another way of saying that if PSML remained as a subsidiary of PGL, more work would have been done in the course of meeting regulatory requirements for going public, involving potential disclosure of the financial affairs of the other companies such as FIC and AIC. In that sense, it was probably a reason motivating the transfer.

Another reason given by Donald Cormie was that PSML, after being transferred to CSL, could better bid for third party business. Having regard to the contents of Exhibits 11 and 236 and Donald Cormie's testimony thereon, this reason is simply not credible and is rejected.

I reject that a reason for this transaction was, in fact, to take PSML public in the expectation of making PGL debt free by having CSL (later CSI) pay down its debt. The evidence tends to show that Donald Cormie and James Cormie intended to move the asset to protect it from the insolvency of PGL. Transferring it at book value and then taking it public hopefully would allow CSL to pay off its debt, and leave PSML beyond the reach of PGL creditors. John Cormie, the evidence tends to show, had the same intentions. It is in this sense that I have accepted that a reason for the transfer was to take PSML public. Marlin believed the transfer to be a tax plan; however, in approving it, the evidence tends to show, he failed as a director in his duty to creditors of PGL.

Counsel for the Cormies have argued that the transaction was fair and reasonable because PSML would be transferred to the ownership of those who were responsible for its success and who provided the investment advisory services, namely Donald Cormie, James Cormie and John Cormie. They point out that the PSML Preliminary Prospectus [Exhibit 270 at 23] states that one of the risk factors relating to PSML was:

> Certain executive officers are primarily responsible for determining the investment philosophy of the Company. The Company does not have employment agreements with any of these individuals. However, each such officer has a significant indirect ownership in the Company. . . .

The clause continues:

> . . .and there are other members of the investment committee who are fully familiar with the investment philosophy developed by these individuals. It is these other members who are responsible for the implementation of the investment strategy.

As noticed earlier, the value of PSML was, in part, dependent upon not only the skill of the triumvirate, but also on PGL employees within the investment department, the distribution network and Principal Group client base, the management contracts, and the goodwill associated with the name "Principal". In all the circumstances, it is apparent and I find that PSML was prior to August 15, 1984 owned by PGL, not the shareholders of PGL and I disagree that the transfer was fair and reasonable on this ground.

They also argue that PGL effectively had control over each of the funds and had the power to contract and, if it chose, to terminate each of the fund's management agreements with PSML. Therefore, a bankruptcy trustee of PGL could effectively take control of the management fee income. As noted above, in the case of at least one of the funds, that would not be the case. The assertion of management that PGL had voting control of the other incorporated funds cannot be accepted for that reason. PGL may have had voting control, or it may not have had voting control. The evidence does not support the assertion. Johnson had testified that PGL had the voting control of the incorporated mutual funds. [7343] He appears to be in error in the case of at least one of the funds. As mentioned earlier, Donald Cormie stated that the voting control was not for the purposes of changing advisors. I cannot accept this argument. In any case, this argument does not address the recovery of any fee income lost in the interim and moreover, if an act is wrong it cannot be made right simply by saying that what was done can be undone.

While management have argued they could have taken their skills, packed up and moved elsewhere, this is the very risk downplayed by the Preliminary Prospectus. The fact of the matter is that PGL paid the salaries of the people who established the mutual funds, paid for the cost to set the Funds up, and owned the subsidiaries which marketed and distributed the funds. Management could take their skills and move elsewhere. But they could not take with them what they had built as, I find, officers of PGL. The argument of management that the transaction was justified because it was their skill that built the value of PSML is directly contrary to the decision in *R.* v. *Olan*, discussed in Appendix 1, which demonstrates that a sole shareholder can defraud his own company.

Moreover, it is doubtful that PGL could terminate the mutual fund arrangements thereby allowing some new company other than PSML to step in as manager. It would not be in its interests to do so. Nor would PSML wish to do so. The best that can be said for the Cormies' position is that they might quit PSML to establish a competing company.

Management had the right to take their advisory skills elsewhere. What they did not have the right to do was to take PSML elsewhere. PSML cannot reasonably be expected to cease to exist upon the departure of John Cormie, Donald Cormie and James Cormie. Indeed, at the salaries being paid to these people, I would expect, for the same money, competent managers for PSML could have been located and hired.

The transfer of PSML at book value, a value grossly deficient from the true value, motivated as it was by the desire not to make PGL debt free as Donald Cormie and James Cormie claimed, but rather CSL debt free, is evidence tending to show fraud. CSL simply took an asset from PGL to enable it, CSL, to pay off its debt to PGL. The evidence tends to show that the transfer was to the prejudice of the creditors of PGL, who were largely composed of members of the public who had purchased promissory notes from PGL. The evidence tends to show that it was to the unfair prejudice of and in unfair disregard of the interests of FIC and AIC, which were dependent on PGL for investment to remedy capital deficiencies. Indeed, the transfer was made during the time when FIC and AIC (in reality, PGL) were negotiating required capital insertions owing to, *inter alia*, the capital demands made on May 11, 1984 and the damage done to FIC and AIC by PGL on March 23, 1984 by Transaction #1.

It should be noted that at the time PGL's consolidated financial statements were under the threat of a going concern note. The financial statements of its subsidiaries showed dismal results — as noted elsewhere, causing Donald Cormie to complain to the auditors. Capital demands were placed on FIC and AIC in May, 1984. Management knew that Transaction #3, closed only a few weeks before, had failed to appease Touche Ross & Co. Pennock wrote: [Exhibit 527 at 24]

> The transaction was executed on June 29, 1984 and we were provided with copies of the agreements in the first two weeks of July. We concluded on July 27, 1984 that, in our judgment, the transaction did not decrease the Group's exposure to loss resulting from the mortgage and owned property portfolios, and we delivered two draft notes we felt required insertion into the notes of the consolidated statements. The company subsequently informed us that these notes were unacceptable particularly the note dealing with the demands of the regulatory bodies. The company further stated that efforts would be made to settle the issues with the regulatory bodies so that the note could be restructured or eliminated. Over the past months, genuine efforts were made to resolve these issues and certain progress has been made.
>
> The note referred to provided:
>
> 10. Contingencies
>
> (a) Three subsidiary companies that have been consolidated into these financial statements invest in mortgages as part of their business. It is the policy to provide an allowance against income to meet anticipated losses arising on the mortgages and owned property portfolio. The cumulative allowance for anticipated losses which has been provided for in the accounts is $5,326,000. Because of the complexities of the real estate market and the economic uncertainty surrounding the underlying value of real estate in Alberta and British Columbia and the present undetermined values of additional collateral securities and guarantees to the mortgages, these companies in total may have an additional exposure to loss of $18,200,000 if the current market levels represent a permanent rather than a temporary decline in value.
>
> (b) Subsequent to the year-end, these subsidiaries received communications from government regulatory authorities requesting information and advising them that additional capital must be raised. Senior officials are presently in the process of dealing with requests. In satisfying the capital requests relating to one of the subsidiaries, the parent company has invested $8,300,000 into capital stock and subordinated notes subsequent to year-end. At the date of preparation of financial statements, the other matters have not been resolved. [Exhibit 526 at 154]

The evidence of J. Stephens Allan [36116-8; 36128-38; 36142-3] is that by December 31, 1983 PGL was arguably insolvent and that in any event, the transfer would make PGL insolvent. Donald Cormie gave evidence that FIC and AIC were in better shape in June 1987 than in 1984. [18542-3] In June 1987 the shortfall was approximately $160,000,000. The shortfall in 1984 was also significant and indeed without full appraisals, the government auditors had FIC and AIC insolvent by yearend 1983 with a shortage in regulatory unimpaired capital of about $62,500,000 for FIC and $24,008,000 for AIC. [Exhibit 550 at 180; Exhibit 551 at 141] A reading of the December 31, 1983 audited financial statements of FIC and AIC, in particular Notes 1 and 9, also indicates quite clearly the insolvency (liabilities in excess of assets) and Donald Cormie embarked on the transaction called Transaction #3 to, the evidence tends to show, hide losses and convince the auditors that going concern warnings and contingency notes would not be required on the consolidated financial statements of PGL for the year ended December 31, 1983. The reality is that FIC, AIC and PGL were insolvent by this time and the evidence tends to show that Donald Cormie knew it and that this transfer of PSML at cost to CSL was done in an attempt to enrich CSL and the other upstairs companies when PGL was insolvent or the transfer would make it so.

D. DEALINGS WITH TROUBLED MORTGAGES AND REAL ESTATE

Forward planning by the Principal Group relating to mortgages and arrears thereon had commenced as early as July, 1983. [Donald Cormie, 17051-3] PGL started a procedure of considering specific potential write downs, and as time passed through 1983, Donald Cormie became more and more involved in forward planning for problem mortgages and owned properties. [17052-3] The mortgages and properties were owned by FIC, AIC and PS&T. PGL did not own any of these mortgages and properties.

During the course of the audit for the year ended 1983, Touche Ross recommended [Exhibit 431 at 120A] that the mortgage portfolio receive the continued concentrated focus of PGL's top management. That resulted in the formation of what Donald Cormie referred to as a "SWAT team", a group to concentrate on the top 20 or 30 owned properties thought to offer the most potential for recovery of value or avoidance of the largest loss provisions. The special group was headed up by Petracca and established in July, 1985. Petracca was given her assignment by Donald Cormie. [15905-7; 17452-3]

Donald Cormie was concerned with the valuation and management of owned property prior to the formation of the SWAT team. In June, 1984, for example, Donald Cormie had directed that each vice president personally take responsibility for one or two of the mortgages against which Touche Ross had required either an exposure note or a loss provision as at December 31, 1983. [Exhibit 442 at 137A, B; 17048-52] He acknowledged that valuation of the mortgages and owned property for the purposes of financial statement presentation was something about which he was very much concerned, because it affected the consolidated financial statements of PGL, for which he had responsibility. [17051-2] Similarly, with respect to the yearend audits, Donald Cormie was personally involved to avoid any write downs he considered unnecessary, which would impact upon the consolidation of PGL. [17452-3] As noted elsewhere, the external auditors and Johnson gave evidence that all write downs had to be approved by Donald Cormie.

Donald Cormie also acknowledged involvement with the so-called top 20 properties which were the subject of attention by the SWAT team. [17454] He characterized them as "opportunities" and not necessarily problems, because "you could do something with them and create value with them". [17454] These properties either were in jeopardy of being written down, or offered an opportunity to increase the value. [17455] These opportunities were administered day-to-day by the special group headed up by Petracca, which included Lance Frazier and Bill Gibson.

It was Donald Cormie's understanding that FIC and AIC were obliged to enhance, maintain and maximize the value of their owned properties while they were holding them; they simply could not "sit on them". [17563-5] He did, however, acknowledge that the issue of how far the companies could go in this area had never been addressed prior to April, 1987. They had never, for example, carried out a development of the magnitude of the Rimrock Inn (*infra*). He gave evidence that while the *ICA* provides that certain authorized investments become a part of the assets on deposit and requires the maintenance of certain reserves, his understanding had always been that the companies were entitled to operate as ordinary corporations apart from those requirements. [17570]

FIC and AIC had, in Donald Cormie's words, to "create value" to offset the large writedowns being made on mortgages and owned properties. It takes money to create value. The expenditures and conceptual approvals relating to projects to be made on behalf of FIC and AIC were approved by Donald Cormie. [Petracca at 11379-81] Donald Cormie's evidence was that he had direct dealing only with respect to expenditures in relation to the "special projects" or the top 20 or 30 "opportunity" projects. [19359-60] While owned properties not under Petracca's administration were dealt with by a Mortgage Investment Committee, of which Donald Cormie was not a member, that committee operated within broad policy established by Donald Cormie. [6259-62; 9129-31]

There are numerous instances of Donald Cormie giving direction with respect to owned properties held by FIC, AIC and PS&T. For example, Donald Cormie gave direction on reporting requirements relating to owned property [19361-3] and with respect to the marketing of owned property. [19363] He approved an owned property disposal program through an unrelated realty concern. [Exhibit 379 at G-6]

Petracca's evidence with respect to the development and management of property was similar. During 1985, it was felt that it would be almost irresponsible to simply dispose of the properties as they were foreclosed; rather, it was necessary to maximize their resale value which could require making some improvements to the properties. Petracca read the *ICA*, which in her opinion was silent on the point, read the *CBICA*, and spoke to Donald Cormie. He indicated that a legal opinion had been obtained some 15 years earlier that improvements were authorized activity for the investment contract companies. Based on that indication Petracca proceeded. Petracca considered this activity to be "simply improving or restoring or renovating existing properties". [10008-10]

In summary, the evidence is that as the real estate crisis advanced, it was determined by Donald Cormie that special or intensive work-out strategies would be applied to those properties which (a) were in jeopardy of large writedowns or (b) had the potential for profitable disposal after development, which would offset other write downs. Thus, there were a number of properties within the portfolio of FIC and AIC which were not only valued on a 3 to 4 year "time horizon", but which also were actively developed with a view to maintaining current book values or, going even further, creating additional value. The evidence which follows shows the efforts of the corporate development department, to which was allocated the top 20 or 30 "problem" or "opportunity" properties, with the specific mandate, as the evidence tends to show, of avoiding write downs or realizing as much profit as possible on disposal in order to offset other write downs. To this task was assigned Petracca; however the overall objective was established by Donald Cormie and Petracca assumed this role in her capacity as an employee of PGL.

As part of this movement Frazier was hired in June, 1985. His mandate, established by Donald Cormie, as confirmed by his letter of employment [Exhibit 263 at 1] was to dispose of $20,000,000 of owned property at book value. In addition to that responsibility, Frazier participated in the valuation of owned properties. Frazier valued the properties from a development viewpoint; thus, his valuations were higher than those of the auditors and the mortgage department. [5676-80; Exhibit 263 at 44] While Frazier obtained third party opinions to support development scenarios, appraisals were purposely not obtained because they would have shown substantial write downs on properties that had to be developed. [5682; 5686; 9998-9] Thus, when the external auditors requested appraisals on FIC and AIC mortgages and owned properties with an aggregate book balance exceeding $63,000,000, for the purposes of the fiscal year 1986 audit, Frazier wrote:

> It is imperative that we do not get these properties appraised, however, we must develop a strategy for dealing with them. Development pro-formas are great but are only appropriate for a very few of these properties. . . . [Exhibit 263 at 242]

Similarly in respect of the 1985 fiscal year end audit, Petracca wrote (the memorandum does not name the author but Petracca acknowledged writing it [9981]):

> Bill [Johnson], you will want to address with Peter Barnes, due to his perception, the fact that we will hopefully not have third party outsiders addressing mortgage valuations since he was concerned that "prudent valuations be utilized due to the great scrutiny of the financial statements under these circumstances". [Exhibit 263 at 15-6]

In short, a number of properties were to be developed and thus, their current value was not considered relevant.

The avoidance of write downs through creating value is not, in itself, of particular significance. While steps were taken to specifically do something to certain properties to avoid write downs or to produce gains, none of this activity, speculative as it was, was disclosed in the information given to the sales representatives and who, as the evidence shows, passed this information on to the buyers of FIC and AIC products. What follows is a small part of what the evidence tends to show was a larger effort by Donald Cormie to ensure presenting the best picture possible in the financial statements and hold off any recognition of insolvency as long as possible.

THE RIMROCK INN

The history of this loan was outlined by Fuhr, PGL's mortgage manager. [22879-86; 22892-905] The mortgage department of PGL was approached to make a loan to Banff Investments Ltd. on the security of the Rimrock Inn in Banff, Alberta. The mortgage manager at the time, Fuhr, asked Green (who had left PGL some time before but was doing some consulting work for PGL) for an analysis. Green provided a report. [Exhibit 516 at 230-231] According to the report Banff Investments Ltd. had charged the Rimrock Inn and other real estate assets as security for a loan from Canadian Commercial Bank for $9,000,000. The mortgage was not fully funded and was outstanding in the amount of $7,300,000. The purpose of the loan was to finance expansion and upgrading of the Rimrock Inn. Green noted that the principal shareholder took over $1,000,000 out of the company in its 1981 fiscal year even though it had a capital deficiency of about $1,700,000 and "in spite of the fact the business was running at a loss and he was leaving unpaid hundreds of thousands of dollars in trade and supplies accounts". The money, Green surmised, probably came from the mortgage draws and was perhaps the reason Canadian Commercial Bank quit advancing it, called the loan in default, and had the hotel placed into receivership. At that point, construction of the renovations had ceased and Coopers & Lybrand was the receiver. Green stated:

> To bail this project out and to complete the hotel as planned will require at least $10,000,000. If the owners had a capitalized equity of $5,000,000 and if the hotel could do about $4,700,000 a year, then it could support a mortgage of $5,000,000 at 21½%. Unfortunately these are not the facts, and the hotel only did $1,100,000 last year.
>
> In view of the receivership, the $1,600,000 in liens, the unpaid accounts, the huge capital deficiency, the lack of supporting financials, past and present, and the unwillingness of the principal shareholder to commit required equity money, this investment proposal has an unusually high degree of risk.

Green concluded:

> When the dust has settled this project will be completed and it will provide an excellent service to those who use it. In the meantime, it is an investment situation best watched from the sidelines.

Fuhr refused to consider the application. Ultimately, it was proposed that there be 20 separate loans, each secured on a separate property, totalling approximately $14,300,000, at 22.5% per annum, over a 3-year term with a $250,000 fee payable on funding. The 20 properties were said to have an appraised value of approximately $30,900,000. All the mortgages were to be cross-collateralized and were to contain cross default provisions. It was a condition of the loan that some 5 properties be immediately listed for sale. Other documentation states that 6 properties would be immediately listed for sale. In any case, the concept was to lend the money out on the basis that some of the security would be immediately sold and the proceeds applied to the debt. [Exhibit 516 at 232-249]

The loan was made. The total funds available for disbursement were just under $14,000,000. Over $9,800,000 was paid to Canadian Commercial Bank, another $900,000 to Northland Bank, and about $700,000 to Principal Group, all for the purpose of clearing prior charges off the properties offered as security. Over $1,000,000 was disbursed to clear liens, writs and related charges, and some additional money was disbursed to cover outstanding taxes, insurance and condominium fees on some of the properties. The fee of $250,000 was taken. There were additional brokerage and appraisal fees, legal fees and disbursements. After all that, there was just over $500,000 remaining, of which Banff Investments Ltd. and the Rimrock Inn received about $129,000. [Exhibit 516 at 242]

Fuhr testified that he had proceeded with this proposal at the direction of Donald Cormie and James Cormie. Donald Cormie and James Cormie followed the progress of the negotiations; "they were constantly phoning and asking how the loan was coming". [22897] Fuhr testified that at an investment committee meeting, Donald Cormie did express his approval to this loan prior to anybody signing the "purchase of land" documentation (which was the documentation used by PGL to evidence approval of a mortgage loan).

The purpose of this loan was to refinance the hotel and provide sufficient money to complete the renovations. There was insufficient money, as disbursed, to complete it. By December 6, 1982 it was realized that the funding had been delayed causing the hotel to miss its peak season. Owing to the decline in real estate values, hope of selling some of the other properties was lost. [22900] In a memorandum Warren (one of the account managers) stated to Fuhr that at the time of the loan the mortgage department had anticipated it would cost approximately $600,000 to complete the hotel; approximately $350,000 had been spent to date but the $250,000 that was left was taken and applied to the mortgage for debt service. [Exhibit 516 at 246-248] There was discussion about postponing the first mortgage on the Rimrock Hotel to a first mortgage of $1,750,000 to be granted to an unrelated trust company to secure a proposed loan in order to acquire funds for completion of the hotel. That proposal did not proceed. [22901] Later Fuhr discovered a proposal document dated October 29, 1982 and approved on November 2, 1982 by James Cormie. The document appears to contemplate a rearrangement of the loans and involved some financing from another lender. [Exhibit 516 at 244] Fuhr noted that it was not properly authorized and therefore he terminated it.

There were some payments made on some, but not all, of the 20 loans after the initial advance. Fuhr testified that none of the payments were made as agreed after the initial advance. [22879-86; 22892-903]

Two of the 4 persons who initially approved the loan were James Cormie and John Cormie. Fuhr testified [22905] that it was Donald Cormie who made the final decision that FIC, AIC and PS&T would proceed with this loan.

At March 21, 1984, the appraised value of the Rimrock Inn, described as market value on a cost basis in recognition of then current economic conditions and the costs incurred to develop the complex to its then present status, was $4,475,000. [Exhibit 370 at 4]

The Principal Group also obtained an opinion of value dated May 20, 1986 showing what the value would be effective upon completion of certain renovations and developments. It valued the hotel at $12,500,000. [Exhibit 370 at 110] This was based on a number of assumptions: completion of extensive recreational facilities; efforts in place to establish a "stress centre", utilizing the recreation area of the hotel, which would be prominently marketed; reconfiguration of remaining space to accommodate meeting rooms, restaurants and so forth; application of at least 3% of anticipated gross revenues to advertising and promotion; demolition or removal of a building to make way for a second hillside tower containing 100 to 125 rooms; and, remodelling of the front of the building. Future estimated market values in the amount of $15,500,000 for the year 1988 and $19,000,000 for the next ensuing fiscal period, which would encompass the 1988 Winter Olympics, were also presented.

Development began after FIC and AIC received title to the Rimrock Inn in late 1985. The object was to make value to cover not only the loan secured against the Rimrock but also the deficiencies on the other Pawluk mortgages. [Exhibit 369 at 437; Petracca, 10097-9; 10104-5] To this end, the hotel would be completed. It would then undergo a fundamental change. By August 15, 1985 documentation had been prepared contemplating renovation of the hotel.

The fundamental change is best described by reference to certain grant applications submitted to the Alberta Ministry of Tourism and Small Business pursuant to a joint federal and provisional tourism generating program. On March 15, 1986 Petracca had written to Alberta Tourism and Small Business setting out the concept: to create "an exclusive, internationally recognized, site sensitive and architecturally unique, destination resort, stress management rehabilitation centre and exclusive spa facility". She sought a grant from the government of approximately $5,000,000 pursuant to the program. As noted below, PGL had previously sought a $450,000 grant in contribution to modernization and completion of the hotel, at a total budgeted cost of about $1,600,000. [Exhibit 369 at 450-462]

A July, 1986 grant application described the concept as the complete renovation and expansion of the Rimrock Inn to a major five-star international destination resort and spa facility incorporating a unique "purpose built spa and executive renewal and convention facility". The project cost was estimated at about $30,900,000. Previous estimates in the evidence were in the range of $25,000,000. It was, in any case, significant development activity. [Exhibit 369 at 467-480]

On September 4, 1986 Marquette Realty & Development Ltd. ("Marquette"), a wholly-owned subsidiary of FIC and AIC and owner of the Rimrock Inn, entered into a contract with the federal and provincial governments to complete the Rimrock Inn. The hotel was to be modernized and completed at an estimated cost of approximately $1,030,000. The approved funding from the government was $450,000. [Exhibit 369 at 536] On June 15, 1987 approximately $321,000 of the grant was paid to Marquette. [Exhibit 369 at 579]

By January 16, 1987 the revised preliminary budget estimate for expansion of the Rimrock amounted to approximately $21,900,000. [Exhibit 369 at 632] The developer (PCL Maxam) and F&A Development Corporation (a subsidiary of FIC and AIC incorporated to carry on the development work [9798]) entered into an interim construction agreement dated February 26, 1987 to expand the existing hotel by constructing 90 new spa hotel rooms complete with support amenity area, 93 new regular hotel rooms complete with support amenities, underground parking structures, staff housing units, and all related demolition, renovation and site development. [Exhibit 369 at 637-48]

By January 31, 1987, expenditures made on behalf of the Rimrock by FIC and AIC amounted to about $1,475,000, including the expenditure of about $1,076,000 to complete the modernization. [Exhibit 263 at 359] By that time, FIC and AIC had expended over $200,000 relating to the spa expansion.

On February 26, 1987 Petracca authorized clearing of the site and excavations, not to exceed a maximum of $500,000. On May 12, 1987 she authorized building a concrete structure and other items amounting to $1,450,000. On May 1, 1987 FIC and AIC assigned to the contractor all of their right, title and interest in certain mutual funds having an aggregate market value in excess of $1,500,000, held within the wholly-owned subsidiary, Marquette, as continuing collateral security for the payment of all indebtedness of F&A Development Corporation resulting from properly certified construction liabilities with respect to the Rimrock Inn. If the market value of the funds dropped, FIC and AIC were responsible to give additional security. [Exhibit 369 at 649-665]

The expenditures continued. Johnson testified that as of the failure of FIC and AIC approximately $2,500,000 was spent. By June, 1987 the status of the expansion construction was described as follows: "there was a big hole there". [6269]

Working papers disclose [Exhibit 370 at 133 A-G] that as of December 31, 1986 FIC and AIC had expended about $1,475,000 on the Rimrock Inn. The working papers tend to show that during the first six months of 1987 an additional $1,400,000 was expended on the Rimrock, for a total of $2,745,000. After June 30, 1987, it appears that an additional $189,000 was expended, for a total of $2,935,000.

Of the $450,000 grant, approximately $321,000 was paid. The payment schedule was interrupted on June 30, 1987. [10123] Petracca understood that the $5,000,000 grant had been approved in the amount of approximately $2,000,000 but due to the events of June 30, 1987 the agreement had not been signed and no documents were issued. [10124]

The spa project, on which construction had commenced, was to be funded through the creation of a limited partnership, the general partner of which was Marquette. To that end, the Rimrock Resort Hotel Limited Partnership issued an Offering Memorandum dated November 10, 1986. [Exhibit 369 at 755] The purpose was to obtain $30,600,000 in funds primarily on the basis that the resort had been designated a project which was of significant benefit to the Alberta economy and the structure of the partnership met the intention of the business immigration program. Provided a subscriber for units in the limited partnership was able to demonstrate his or her qualification as an "investor" as defined under certain regulations made pursuant to federal immigration legislation, he or she would satisfy certain of the criteria required for admission to Canada as a landed immigrant under the "investor category" as prescribed in the regulation. The offering was to be marketed to residents of the Far East.

The evidence shows that on November 19, 1986 Perry Monych (Petracca's assistant) sent to Gordon Oxley (the agent designated to sell the units) in Hong Kong, 200 copies of the Offering Memorandum. In addition, Oxley had, prior to November 19, 1986, taken the document to Hong Kong. Petracca also sent a copy of the Offering Memorandum to Peter Walsh of Messrs. Pannell, Kerr, Forster on November 25, 1986, and it was submitted to the Hong Kong Securities Commission for the purposes of obtaining approval to market the offering in Hong Kong. [Exhibit 369 at 753-4, 810, 811, 815-8]

The Offering Memorandum purported to carry the signatures of the officers of Marquette, being Petracca and Patrick. In reality, it did not carry Patrick's signature. Instead, his name was typed, and placed within quotation marks. On November 19, 1986 he received the Offering Memorandum. He had been advised that it had been published and issued to the public purporting to have been signed by him as to the pro forma balance sheet and representation certificates. He stated that he had not signed either of those documents and no request was made of him prior to the issue and distribution of the Offering Memorandum for his approval or his signature. In his mind, that was an extremely serious matter and he wished a meeting with Petracca and Donald Cormie about the implications of that action. [Exhibit 369 at 754] Patrick testified that upon taking the matter up with Donald Cormie, he was told that his attitude was one of "exaggerated professionalism". Donald Cormie said the statement had been made in a vice president's meeting and was not directed at Patrick on this matter. [8739-40; 8838; 17615-6] I prefer the evidence of Patrick over that of Donald Cormie.

Pannell, Kerr, Forster had earlier (August 15, 1986) provided Petracca with an opinion of value of the Rimrock Inn. On February 18, 1987 that firm wrote Petracca and stated that its opinion of value as at August 31, 1986 had been referred to in the Offering Memorandum (which had by now increased to $34,100,000, was dated January 31, 1987 and was this time actually signed by Mr. Patrick) as an "appraisal". Pannell, Kerr, Forster stated that the opinion had been given for the purpose of assistance in arranging mortgage financing and was not intended for publication nor to be used for any purpose except as indicated without the written consent of the authors. The purpose of the opinion and the restrictions on its use are actually stated in the opinion letter. Pannell, Kerr, Forster made certain demands, in default of which it planned to contact appropriate securities regulatory authorities in order to publish a disclaimer of the information contained in the Offering Memorandum. In a second letter dated April 20, 1987, Pannell, Kerr, Forster labelled the statement using its name as "false and misleading" and demanded that an erratum sheet be published.

Notwithstanding those demands, on March 2, 1987 the Offering Memorandum was forwarded to the Agent General Asia/Pacific for Alberta. Oxley was by then distributing the document, and on March 30, 1987 a PCL employee (Yuen) travelled to Hong Kong with the Offering Memorandum in his hand to attempt to sell some of the units. On April 6, 1987 amendments were distributed to the Offering Memorandum but they did not address the concern raised by Pannell, Kerr, Forster. [Exhibit 369 at 927-32, 934-5]

According to a letter dated May 11, 1987 Petracca forwarded an additional amendment to Hong Kong which met the concerns of Pannell, Kerr, Forster. Mr. Yuen was to be provided with the amendment and apparently Petracca herself was to forward the amendment to Oxley. [Exhibit 369 at 939-40] Petracca's position was that she had not acted in bad faith. [10179-81]

Petracca testified that while the offering memorandum had been sent with Oxley to Hong Kong in anticipation of it being approved by the Hong Kong Securities Commission, she felt that she had plenty of time to obtain Patrick's signature prior to it being issued to the public. She hoped that Oxley would be able to get the Hong Kong Securities Commission to approve the document which would then be with him in Hong Kong for distribution. [10154] She said it would have been "nice" if Patrick had signed it before it was dispatched with Oxley to Hong Kong, but it was not required. She said that she did not take any steps to tell Oxley that Patrick had not signed it; there was no need to do so because she knew it would not be immediately issued to the public and there was plenty of time to get Patrick's signature prior to that occurring. Later in her evidence, she said she did not recall whether or not she told Oxley that Patrick had not signed it. [10156-7]

As of July 16, 1987, there were no subscriptions to the partnership.

The Pannell, Kerr, Forster opinion dated August 15, 1986 is of some importance. It concluded that a reasonable estimate of market value of the Rimrock Inn as at August 31, 1986 was approximately $12,000,000. On April 15, 1987 Pannell, Kerr, Forster advised that because approval had been obtained to expand the property to a larger hotel, the value of $15,200,000 appeared to represent a reasonable value for the entire project, if not for the existing hotel alone. On June 19, 1987 that firm gave an opinion that it was doubtful that the present hotel facility could command much more than $8,500,000 plus the value of the existing approvals made to date. The opinion was that if the property were upgraded by converting some rooms to luxury rooms and making some cosmetic changes, the value would be around $10,000,000. The firm opined that completion of the hotel and spa seemed to be the most logical route at the time, although no value was given. [Exhibit 369 at 1017-18, 977-994, 1030-36]

Donald Cormie testified [17566] that he was part of the approval process on the Rimrock development, and he assumed that additional construction was permitted under the *ICA*. The directors of the companies had an obligation to maximize the value of the property during the holding time. He testified that he approved the concept of the offering and stayed informed on the Rimrock since its development would have an important impact on the capital accounts. [17612-4; 17624-5]

It is noted that construction commenced before any subscriptions were received on the offering. It was a high risk development from FIC's and AIC's point of view. If the offering was unsuccessful, FIC and AIC had 2 alternatives: first, to scrap the development; and secondly, to finish it. This development was to exceed $25,000,000.

THE PRINCE ROYAL HOTEL

FIC and AIC held a debenture dated March 2, 1981 issued by Prince Royal Inn Limited, formerly known as Charter Towers (Calgary) Ltd., to secure the principal sum of $7,050,000 together with interest.

The original loan was approved on February 19, 1981 by various officers, including James Cormie, Ken Marlin and Donald Cormie. The loan was secured on some 10 properties, with a total appraised value of $17,800,000, prior charges (on 7 of the properties) of approximately $4,500,000, leaving equity of approximately $13,300,000. The borrower was James Hudson Investment Corporation Limited. It was a term of the agreement that all funds advanced under the loan had to be used for the purchase of Charter Towers Limited and purchase of furniture for Charter Towers Limited. Charter Towers was later renamed the Prince Royal. [Exhibit 371 at 1044] That company then provided a debenture, charging the assets, as collateral security for the debt obligation. There were corporate guarantees and other securities taken to secure the loan as well. [Exhibit 516 at 177-9]

The Prince Royal was an important piece of collateral security. One of the mortgages was foreclosed in August, 1985, by which time foreclosure proceedings were outstanding on 3 other properties. Two other mortgages were foreclosed by the holders of prior charges. Three other properties had been foreclosed in mid-1984 and sold to 314986 Alberta Ltd. (Transaction #3). The last property had been redeemed by the borrower. In 1985, some of the properties were not written down because the value of the Prince Royal was applied to support the shortfall. [Exhibit 541 at 84-98]

In 1986, according to audit working papers, the value of the Prince Royal was considered to be approximately $14,500,000. The figure seems to have been derived by adding together: certain receiver fees written off; a certain judgment (accounting for the mortgages lost to the prior charges) written off; property taxes paid on the properties; prior mortgages payable; recovery of reserves; "mortgage special income"; and Prince Royal debenture interest. The other mortgages and properties collaterally secured by the debenture were written down to estimated values resulting in a reserve expense; however, the reserves were recovered by setting up the Prince Royal debenture as an asset on the books of FIC and AIC. [Exhibit 541 at 88; 125-6]

When the government examiners received the June 30, 1986 interim financial statements of FIC and AIC, they noted what they termed an unusual increase in mortgage interest income. The increase for FIC was approximately $5,800,000 and for AIC approximately $2,000,000. It was explained to Eldridge by Johnson that the Prince Royal debenture permitted interest and losses on the individual mortgages to be charged against it. The increase in mortgage interest represented the amount of interest so charged from the date of last recording to June 30, 1986, the basis for charging it being that the company expected to obtain title to the hotel on August 15, 1986. Interest had never before been accrued on this debenture.

As at year end, FIC recovered reserves exceeding $3,000,000, and some $3,800,000 was recognized as income in FIC on the Prince Royal debenture. [Exhibit 541 at 110] AIC recovered reserves of about $1,760,000 and recognized "mortgage special income" in the amount of $926,581. [Exhibit 541 at 88]

The amount of interest income recognized prior to year end was established by computing the difference between interest booked on the mortgages and interest at 20% (this was referred to as an income "bump"). FIC also received a "bonus" regarding "operating business". Entries were made to credit FIC and AIC income accounts and to debit the debenture asset account. Thereafter, debenture interest was accrued and charged. Nicholson testified that the income "bump" was reversed prior to year end. As can be seen from the audit working papers, a lesser amount of interest was nevertheless included in the year end accounts. [23679; Exhibit 371 at 1265-71; Exhibit 271]

Johnson testified [6740] that recording the collateral security on the books of the company retroactively in June, 1986 was pursuant to the instructions of Donald Cormie. The audit working papers similarly show that Donald Cormie and Patrick argued that the debenture was the primary security and carried an interest rate. Legally, it was still outstanding and carrying interest of 20% because the borrower could come back at any time and pay off the debenture, taking back the Prince Royal and other properties. [Exhibit 541 at 84] It is not for me to assess the merit of such an argument. This is more evidence tending to show Donald Cormie's involvement in maximizing reported income through whatever means possible.

Glen Eden Realty & Development Ltd. ("Glen Eden") obtained title to the Prince Royal on August 19, 1986 by purchasing it from the receiver and manager. The stated consideration on the title is approximately $9,297,000. [Exhibit 371 at 1104] According to the Offer to Purchase, the consideration consisted of $10,000 by way of deposit; $2,250,000, more or less, by way of assumption on the closing date of mortgages registered against the properties; and $6,978,730 to be paid by Glen Eden to the holder of the debenture (namely, the investment contract companies and PS&T) in reduction of the indebtedness secured thereby, provided that such payment would first be applied to the indebtedness of the receiver and managers which had been appointed both by the first mortgagee and the Principal Group. Payment to the receiver on the closing date was to be in an amount sufficient to pay all property and business tax arrears. By subsequent agreement, Glen Eden further agreed to pay approximately $421,000 to unsecured creditors. [Exhibit 371 at 1061-1102]

Glen Eden was now the owner of the Prince Royal. Johnson thought its value was between $4,000,000 and $5,000,000. [6838] An appraisal on file dated December, 1984 apparently indicated a value of $4,500,000. [Exhibit 371 at 1055]

Petracca testified that by September, 1986 she was considering renovations. The total renovations were to amount to about $2,300,000. [Exhibit 371 at 1146] The Prince Royal was to be an all-suite hotel, except it was not in "particularly good visual condition" and it lacked food and recreational facilities. Petracca also noted that the net income from the property after participation was positive but "relatively minimal". (The Prince Royal is situated on property owned by an insurance company. According to a Pannell, Kerr, Forster study, the ground lease participation was 25% of the participation basis, which was gross receipts less applicable deductions including ground lease rental, amortization payments on a mortgage made in favour of the insurance company, real property taxes and an allowance for general expenses.) It was necessary to improve the revenue stream in order to maximize the value and sell it. Again, application was made for a $450,000 grant, which was being processed at the time the companies failed. Upgrading of the rooms and renovation of the hallways was undertaken. These renovations were paid in part from the approximately $500,000 in deposits received pursuant to contracts for use of the hotel during the 1988 Winter Olympic Games. Petracca testified that probably $1,200,000 was spent on renovations by June 30, 1987. Donald Cormie approved the renovation program. [10235-41]

By December 31, 1987 the total renovation costs paid by the Prince Royal Inn itself amounted to approximately $896,000, with FIC and AIC paying $1,173,000, for a total of approximately $2,069,000. The actual amount paid by FIC and AIC prior to their failure was $786,000, leaving a payable of $387,000. [Exhibit 371 at 1304 A-B]

In a market study prepared by Pannell, Kerr, Forster, which was received shortly after the collapse of FIC and AIC, the potential projected property value of the Prince Royal as of January 1, 1988 was said to be in the range of $20,700,000 to $25,100,000, depending upon the capitalization rate employed by the valuator. This was based on projected revenue and expenses after renovations. [Exhibit 371 at 1174-1260] The figure attributes value to both land and building. The land is owned by an insurance company. Petracca testified that about $15,000,000 would probably be allocated to the building. [10264] She also said that the insurance company felt that the land value was about $7,000,000, which would be deducted from the valuation. [10268]

Donald Cormie took the decisions to acquire Prince Royal and to renovate it. His evidence was that he was "in favour" of renovation [17746-51], while Petracca testified that he approved it. In fact, I find, he approved the renovation activity since I am unable to understand, within the budgeting system of PGL, how Petracca could obtain the necessary funds without his approval.

Wooldridge noted that the value of the asset was considered by Deloitte Haskins & Sells and the companies to be approximately $14,000,000, based on an income valuation prepared by Pannell, Kerr, Forster on the assumption that $2,600,000 of renovations would be completed. Wooldridge's review indicated that the value of the hotel based on income capitalization was reasonable, although he questioned the capitalization rate and whether or not the renovations would be completed and the effect that might have on the value of the hotel. [Exhibit 545 at 346]

KONA

This loan was made to Westmoreland Capital Ltd. in November, 1981. The loan was for $650,000 (Canadian) and as security, Westmoreland mortgaged raw land in Hawaii, appraised in 1981 at $1,400,000 (Canadian). The purpose of the loan was to pay a loan owing to a Hawaiian trust company which had the property under foreclosure and which wanted to be paid out owing to adverse publicity from an aboriginal land claim dispute. Development of the raw land was projected to be 5 to 10 years in the future. The mortgage manager said that it was a loan that he ordinarily would not have liked to do but in view of the problem that the Principal Group had, he felt that it was "possibly a good investment". [Exhibit 516 at 186; 22912-15] The original purchase of land document was approved by James Cormie on March 27, 1981. The operative purchase of land document was signed November 23, 1981. [Exhibit 380 at 94, 103]

By February 2, 1983 this account was in arrears. By July, 1983 foreclosure proceedings were underway. In March, 1984 a court in Hawaii approved the foreclosure sale of the property to FIC at a price of $480,000 (U.S.) [Exhibit 380 at 161, 164, 261-4]

FIC attempted to have the original 1981 appraisal reviewed by its authors. The authors pointed out that the county had imposed a water moratorium 3 weeks after the original appraisal report was completed, which affected the value. They also pointed out that demand for single family lots in the area was slow, with an oversupply since late 1980. The value conclusions presented "as if" zoned for residential subdivision of any type had to be considered invalid in the current market. No opinion of value was provided. The foreclosure commissioner had the property appraised effective March 10, 1984. The final estimate of value was $430,000 (U.S.) [Exhibit 380 at 226-7, 251]

On July 24, 1985 appraisers retained by Petracca concluded a preliminary value of $665,000 (U.S.) for the property. The letter concluded:

> Based upon these conclusions, we have both agreed to cancel the assignment until which time you feel market conditions and/or the subsequent rezoning of the property is obtained. . . . [Exhibit 380 at 432]

FIC's loan balance as of October, 1984 was approximately $1,000,000. [Exhibit 380 at 316] The account was undersecured.

Petracca testified [10748-88] that the plan was to rezone and subdivide the property, acquire water rights to service the lots, and sell the result to a developer. The purchase of rights to supply of water was necessitated by the subdivision plan. There was also a possibility of negotiating with a Japanese development company which had been acquiring property around the Kona site and had expressed an interest in purchasing it. Through the spring of 1987 Petracca received recommendations that the property be listed at $2,250,000 and $2,130,000 if the property were listed as developable land with zoning and water rights, and at $650,000 "as is". Another company expressed the opinion that the existing value of the property was $2,300,000, and with the appropriate zoning would be $3,600,000. [Exhibit 380 at 472-5, 480-1]

By January 31, 1987 approximately $480,000 had been spent on this property, bringing the book balance on the account to about $1,567,000. By June 30, 1987 the expenditures amounted to $518,240.80. This included purchase of water rights and costs associated with planning development in order to obtain zoning approval. [Exhibit 379 at G-1 to G-5] As part of this transaction, FIC also agreed to purchase adjacent property for approximately $150,000 [10773], of which approximately $20,000 was paid prior to the collapse. [10785]

It is noteworthy that on September 24, 1986 Petracca was told by the project planners in Hawaii that a certain company was willing to buy the site for $1,000,000 cash (U.S.), plus return of the money spent to date on water commitment fees and assignment fees, subject to acquisition of some other lands. The offer was turned down because Petracca felt that she could get $1,000,000 more for the property in six months. As Petracca said:

> But I sincerely felt that we had so many problem properties, that this was the one property that had a good profit potential and that I wanted to see us realize it to offset some of the other losses. . . . [10767-8]

The comment describes why value was being created.

Donald Cormie testified that he viewed the property on two occasions for the purpose of assessing whether or not any proposals relating to it were reasonable and to determine the status of the surrounding development in the area. In terms of the decision to purchase the water rights, the following exchange occurred during his testimony:

> Q Were you party to that decision?
>
> A Yes, I was in favour of that.

I take that to mean that he was a party to the decision. Later he said the decision to acquire water rights for this FIC property was made in consultation with him. Donald Cormie also testified that he instructed that he wished to be kept informed about the property. He agreed that he was party to the decision not to attempt to sell it, but to go ahead with rezoning and subdivision (although he said, the property was always with a local real estate agent and available for sale). He was also a party to the decision to acquire additional land adjacent to the parcel so as to enhance the value. He testified that he assumed Patrick would review the question whether or not that purchase was authorized under the *ICA*. [17630-46]

WOODGREEN

This raw land secured a loan exceeding $4,000,000 and had a foreclosure appraisal value of approximately $1,200,000. It was decided to rezone the property to single family lots.Petracca was told by Royal Lepage, the marketing agent for the property, that the final net realizable value of the rezoned property was estimated to increase by $2,800,000. To achieve this increase in value FIC and AIC spent about $1,200,000 to do the street and engineering work required to qualify the property for zoning. [10841-4]

MOUNTAIN VILLAGE

Principal Group (FIC and AIC) held a second mortgage on a property securing a loan due a borrower called Treherne. The first mortgagee was foreclosing on the property. Principal Group was not prepared to assume the first mortgage. Accordingly, the second mortgage was traded and used as a partial payment on the purchase of a 170 suite apartment project in North Vancouver, B.C. called Mountain Village. The transaction was developed by Lance Frazier and approved by Petracca. Petracca and Marlin signed the transfer documentation.

FIC and AIC took title to Mountain Village in the amount of approximately $11,500,000. In payment, FIC and AIC transferred the Treherne mortgage at book value, $3,350,000, assumed certain mortgages owing to Montreal Trust in the amount of approximately $893,000, and granted a mortgage back to the vendor in the amount of approximately $5,181,000. Finally, FIC and AIC paid $2,051,000 in cash to the vendor. This occurred in December, 1985. Frazier testified that the second mortgage held by FIC and AIC was worthless:

> THE INSPECTOR:
>
> . . . Can you tell me why these people -- why you'd buy it for 11½ million with the appraised value at 9 million?
>
> A The appraised value at 9 million was an '84 appraisal. The 11½ was what we anticipated it being at with a rental increase in the coming year.
>
> THE INSPECTOR:
>
> What was the -- tell me, why would the people selling the property take the $3.3 million second mortgage that was being foreclosed as part payment?
>
> A They -- it was a year-end for them. They were happy to take a sale, show a profit on -- they had owned this property for a number of years and they obviously were not -- sorry, sir. They weren't going to wait for the improved value.
>
> THE INSPECTOR:
>
> Assuming [the vendors] don't give their money away?
>
> A No, sir.
>
> Q And presumably, they knew the $3.3 million wasn't worth anything?
>
> A Yes, sir.
>
> Q But to make the deal look good, they raised the price 3.3 million and took that as part of it; is that it?
>
> A Yes, sir. [5671-2]

The property was revenue-producing. Rezoning was underway with the assistance of a Vancouver architectural firm. There was a letter on file dated March 30, 1987, suggesting a value in the amount of $11,600,000 assuming upgrading of the suites and correction of deferred maintenance. The letter notes that as of September 30, 1984, there was an appraisal at $8,900,000. The new value of $11,600,000 corresponded roughly to the purchase price. [Exhibit 263 at 335]

Petracca testified [9989] that through this transaction the companies exchanged a second mortgage for a fully-occupied apartment building by contributing the mortgage and the cash. She said Frazier did the deal and that it avoided a significant loss. She thought it was "a very commendable action" because there was a sure write off on the Treherne loan, there was "just nothing we could do about it at all". [9990] Now the companies had a property which over time at least had the possibility of recovering the potential loss and at the time it was valued at the same amount as the purchase price. [9990]

Petracca also testified [10845-6] that she knew from discussions with realtors in the Vancouver area that FIC and AIC would have been able to recover the full amount invested once they had spent about $440,000 renovating the suites. At the time of the collapse, the companies were also working on obtaining approval for building another 68 suites on the property. With that approval and the expenditure of $440,000 "we would have recovered the full amount spent". [10846]

Frazier testified that the auditors did not reverse this transaction. Rather, the companies, faced with a large loss, were able to convert it into a $100,000 appropriation of retained earnings. [5752]

Wooldridge characterized this as a "worthless second mortgage capitalized on purchase of property". [25037] He reported that part of the consideration was the worthless second mortgage, used to buy a piece of property that was appraised at $8,000,000, thereby inflating the purchase price to $11,500,000. Wooldridge deducted the book value of the second mortgages, and the amount of the vendor take-back mortgages (he said, "surely the mortgage ought to be deducted from the carrying value of the qualified asset") from qualified assets, and also concluded that the companies' income and retained earnings had been overstated by $3,350,000, less the 1986 write down which he said was $452,320. Johnson, on the other hand, disagreed that the transaction was a sham and that the cost base of Mountain Village be reduced. [6806] [6801-7; 25037-9; 25058-64; Exhibit 545 at 77-8, 288-90]

Two statements of adjustments were found within the files of PGL. The only material difference between them was the addition of the Treherne second mortgage. [Exhibit 545 at 77-81] The evidence tends to show hat the value of the transaction was inflated to dispose of the worthless second mortgages, and that Petracca was responsible for the transaction.

CPF ADVISORY SERVICES

It was decided to mortgage owned properties to a mortgage company in order to obtain a loan, invest the proceeds into Principal mutual funds which would earn a 20% return, and then accumulate a fund that could offset the book balance on the owned property asset, thereby making it easier to recover the difference between the book value and eventual sale price. [10678-9; 10686-7]

Petracca made application for a loan to a company called CPF Advisory Services Ltd. ("CPF"). Effective February 23, 1987, FIC and AIC borrowed $4,185,000 from CPF against the security of certain foreclosed properties, including an apartment building which already came back from 314986 Alberta Ltd. (the Princess Apartments, see Transaction #3) and one of the buildings which was security for the Hudson loan (see Prince Royal Hotel above, which was the collateral security to that group of loans). It was an interest only mortgage at Royal Bank prime plus 1.75% per annum, the due date of the mortgage being February 1, 1990. A numbered company called 358901 Alberta Ltd., a wholly-owned subsidiary of FIC and AIC, received the funds and invested them, and guaranteed to FIC and AIC the liability under the mortgage.

PGL would guarantee performance of the mortgage to CPF and FIC and AIC would guarantee that possible liability to PGL. PGL's guarantee was necessary to complete the transaction because FIC and AIC financial statements were not released to CPF. However, CPF agreed that it would not require to see them if PGL would agree to guarantee the loan and if PGL would release its financial statements to CPF, which was done. [10682-4] As noted in the section on certain significant transactions, it was asserted from time to time that PGL's policy was not to give guarantees. A separate financial statement was prepared for 358901 Alberta Ltd. The liability and the mutual fund asset were not to be shown in the books of FIC and AIC. In a memorandum to the finance department Petracca stated "since this is confidential, would you please ensure to have it properly treated and segregated within the accounting department". [Exhibit 379 at 36-7]

There was no legal opinion obtained before the transaction was completed. After it was completed, Petracca obtained a draft legal opinion dated June 5, 1987 which stated that counsel were unable to provide an opinion as to the validity of the transaction, but commented that perhaps the investment might be included under the "basket clause" of the *CBICA* if preferred shares were issued. The letter pointed out that under the *CBICA* ownership in common shares was always limited to 30% of the outstanding shares of the corporation in which the investment is made. Petracca testified that she never realized that the 30% limit on the holding of common shares would have applied to holdings within the "basket clause". [10689-91]

Petracca asked for the legal opinion after the fact. At first [11336] she denied that she was not certain whether it was legal for FIC to mortgage its property for the purpose of buying mutual funds; rather, she was looking at the business aspects. Then she said she consulted a lawyer "just during or right after this particular process" and that the main objective in her mind was trying to get more income into FIC. She thought at the time, while she had some concerns, "that surely there couldn't be anything wrong with that" and that "I didn't see anything that said you couldn't do it". [11336-40] Finally:

> Q You, in fact, asked for the opinion after the fact, didn't you?
>
> A Yes, I did, because I was concerned as to the -- because I didn't -- you know, there was nothing that I could see that said we couldn't do it, but, again, there was nothing that I specifically saw that this specific type of action could be taken, and I just wasn't sure. [11340]

She testified that while doing the transaction, she mainly focused on the business decision and while she was proceeding, there did not seem to be anything that she could find that said she could do it. Because of that, she decided to get a legal opinion that said "this is fine, just in case it isn't". [11340]

Petracca denied that she structured the transaction so as to conceal it from the monthly statements which were filed with the regulators, and contended that it was structured so as to isolate the funds from the operating funds of FIC and AIC so that others would not attempt to spend them. [10680-1; 11333-5] Yet, she was unable to explain why she had written in her memorandum to the finance department "since this is confidential, would you please ensure to have it properly treated and segregated within the accounting department". [11341-7]

The June 5, 1987 draft legal opinion states:

> We understand from our telephone discussions with you that one of the lenders requires an opinion to the effect that a matching loan or investment from FIC and AIC to the subsidiary constitutes an eligible loan or investment under the ICA. [Exhibit 379at 43]

Petracca identified that lender as Canadian Imperial Bank of Commerce, which was to loan even more money to purchase more mutual funds. That transaction did not occur. It was put to Petracca that it did not even occur to her to get a legal opinion until that bank requested one; then the following occurred:

> A No, Mr. White, that is quite inaccurate because when you look at my instructions, there is some other correspondence somewhere in my PGL files that indicates when I was negotiating with CIBC, and this transaction, and I believe my instruction to Mr. Ferguson -- this was simply an afterthought because after we had done this particular transaction, I had also contacted CIBC to see if they would give us a matching loan. That was not the reason for the opinion.
>
> Q Mrs. Petracca, you asked for the opinion on May 21, 1987 concerning a CPF transaction that you had completed effective February, 1987.
>
> A I'm not sure when the documents were signed. I don't think it was in February, was it?
>
> Q Well, let's just go back.
>
> A Yes, I found it, you are right.
>
> Q I am right?
>
> A You are right.
>
> Q So then, three months later you asked for an opinion, and in Mr. Ferguson's response he says that one of the lenders wants the opinion. Now, what is the afterthought, Mrs. Petracca?
>
> A Because I was doing both of these transactions, one subsequent to the other, meaning, we had done the mortgage against the properties and investing in mutual funds, and I then contacted CIBC and said, look, is there a way to get a matching mortgage with respect to this. When I was speaking to Mr. Ferguson, that was one of the aspects.

> I had obviously forgotten about it you asked me about it, because the primary purpose for getting the legal opinion, in my mind, was because I didn't see anything that said you specifically can do that and I was uncertain about it. That is why I asked him. [11354-5]

Donald Cormie was aware of the transaction from its inception and testified that while he did not have to approve it, he was not against it and acknowledged that the transaction could not have gone ahead without the guarantee of PGL. [17898-901] According to Donald Cormie, it never occurred to him whether or not the transaction was permitted under the legislation. He assumed that any legal problems had been worked out through the use of the numbered company, and said that he was not part of any discussion that the numbered company could be used to avoid the prohibition against FIC and AIC purchasing Principal mutual funds which Owen had pointed out in his legal opinion of 1983. [17901-4]

The transaction is more evidence tending to show the propensity of Donald Cormie, and in this case Petracca, to structure intercorporate transactions so as to relieve FIC and AIC of their problems. There is further evidence tending to show violation of the *CBICA* through ownership of all the common shares of another corporation. The creation of 358901, an intervening corporation, was an attempt to circumvent s. 52 of the *CBICA*. Further, I find that Petracca had reason to believe the transaction was illegal; otherwise, she would have had no reason to attempt to hide it.

CONCLUSION

There is no analysis in the evidence of how much FIC and AIC spent on developing or renovating owned properties. There were other expenditures beyond the development activities outlined above. For example, audit working papers [Exhibit 538 at 15, 19] indicate that during 1984, one of the changes to the owned property account was described as capital costs incurred, including payouts of first and second mortgages. The figures were $7,284,000 for 1984 and $4,114,000 for 1985. The figures are not available for AIC.

All that can be concluded is that the companies spent many millions of dollars in the maintenance, acquisition and development of properties. In many cases, money was spent to create value which was not already there. In that sense, the companies operated as real estate concerns and in conjunction with the use of long-term valuation methods, their books became a reflection not of their current condition, but rather of what they might become if the real estate market recovered and if able to complete the plans and dispose of the properties.

The methods chosen to value real estate in FIC and AIC are not the only methods available. In his draft report dated February 20, 1987 [Exhibit 545 at 39] Wooldridge stated:

> . . . the Companies continue to record income on these assets and do not record provisions for losses on delinquent accounts and questionable security if management believes that the value of underlying assets will increase in the future. We, and others, believe that future value is not an appropriate basis in these types of companies for evaluating real estate related investments. In addition, the use of future value is contrary to asset valuation criterion set out in the Investment Contracts Act. If this interpretation is correct, and the companies are not recognizing non-earning assets and not providing for losses, then we believe that the financial statements at December 31, 1986 may be overstated by an amount significantly in excess of the amounts reported herein.

In his oral testimony, Wooldridge stated:

> Recognize losses when losses are there. The handbook, of course, refers to temporary decline. We are now in 1987 and real estate in Alberta and western Canada went into decline in 1980, '81, '82. If it's now, in '87, not a permanent decline, I don't know what is a permanent decline. Certainly the recording of — the reporting of carrying values and accounting

> principles that have been established for financial institutions, generally banks and trust companies, requires that current market values and future values not be considered in reporting and preparing financial statements. [25044]

Wooldridge also noted in his subsequent report:

> . . . In other instances the carrying value is based on an estimated market value at a future time dependent upon certain things being done or events happening such as legal subdivision of lands or in fact a full development of a site. [Exhibit 545 at 288]

Wooldridge testified that the mortgages and owned properties were probably overvalued as of the Spring, 1987. He noted that the companies had taken the high end of the value as opposed to the low end. Using a rough calculation, he suggested that owned property was overvalued in the amount of $10,000,000 for FIC and $3,000,000 for AIC. [25108-9]

Wooldridge also testified that the valuation of real estate under GAAP for a real estate development company is different from the valuation for financial institutions. He stated:

> If you look at real estate development companies that exist in our country . . . they will carry a piece of property for a considerable period of time, capitalizing interest costs, constructions costs, taxes, all costs related thereto. Their purpose is not one of resale, but one of development and, therefore, the auditor, under GAAP, generally doesn't have to worry about what is that property worth in the market today if the company tried to sell it because it is there. The company's purpose is one other than resale or security, it is one of development. The financial institution has on its balance sheet real estate which is really another form of a loan and, therefore, the asset realization test is more important to it than it is for a development company. Therefore, the marketability, the gap [sic: GAAP] is concerned more with the net realizable value of those particular assets. [25261-2]

In his view, the valuation of owned property described in the FIC and AIC financial statements for the year ended December 31, 1984 was more appropriate for a real estate company than a financial institution, and that the investment contract companies were financial institutions. [25262-4]

In a letter dated August 29, 1988, written to the Investigation and entered in evidence as Exhibit 572, Wooldridge supported his statement that valuation of real estate for a real estate development company is different from that for financial institutions. He noted that authoritative studies make a distinction between real estate held for long-term development and real estate held for resale. For example, in a study entitled Accounting for Real Estate Development Company Operations [Exhibit 573 at 19-20] it is stated:

> . . . In the case of land held for resale, a loss representing excess of carrying value over market value should be written off in the year the difference arises. In the case of land held for development, it is not ordinarily necessary to make provision against any excess of carrying value over market value, provided there is reasonable expectation that the planned investment will yield an adequate return based on carrying values. What constitutes an adequate return in an individual case would depend on the risk involved and on the returns available from alternative investments at the time the land is purchased. However, the expected return should include recovery, over a period of time, of investment in depreciable assets and all carrying costs, together with a fair yield on invested capital.

That same study states: [at 19]

> When land is held for resale, either currently or at an indefinite future date, it is in the nature of inventory. For accounting and financial reporting purposes, it is therefore governed by the lower of cost and market principle. Accordingly, it is proper to include applicable carrying charges in the cost of land but it is also necessary to ensure that the book value of the land does not accumulate to an amount in excess of market.

Wooldridge pointed out that real estate acquired by a financial institution by way of foreclosure is real estate which must be considered inventory. There is no intention that the real estate will be of use for the institution's own purposes, and the institution is not in the business of developing real estate:

> There is therefore no question but that the real estate so acquired by way of exchange for a debt owing is of the nature of inventory. [Exhibit 572]

This is precisely how Pennock had treated owned property during the course of the 1983 audit.

It is utterly inconceivable by any stretch of the imagination that FIC and AIC were real estate development companies. They were certainly not represented to the public to be such companies and they are not permitted under the *ICA* to become such companies. It is one thing to maintain property during the holding period by covering the payment of taxes and other charges necessary to maintain control of the property and by keeping the property in a reasonable condition. It is quite another to expend large sums of money on the redevelopment, expansion, additional construction, and completion of the property. Development activity is not permitted under the *ICA*, in point of law; therefore, this activity is evidence tending to show violation of the *ICA*. Moreover, the activity was speculative and dependent for its ultimate success not only on completion of the projects and economic recovery within the real estate market (in order that the projects could be sold) but also on the ability of the companies to continue as going concerns during the interim. There is little doubt that the "development" activity enhanced the value of the property, perhaps at dubious cost. That is not the permitted business of the investment contract companies.

It may be that GAAP permits these valuation techniques within a financial institution. It is not my function to determine whether or not what the auditors did was in accordance with GAAP. There is no evidence tending to show matters within my mandate in respect of the auditors, namely that they acted fraudulently or dishonestly. It is management's ultimate responsibility to ensure that the activities of the company are proper. In this task, the evidence tends to show that management failed. The activity of Donald Cormie, and Petracca as an employee under his direction, with respect to these loans and properties, including the method of accounting for them, was intended to maintain the values of the properties to protect the balance sheets of FIC and AIC in the hope that some uncertain economic recovery would ultimately camouflage the inflated recorded values for such loans and properties.

Donald Cormie did not honestly believe that the real estate market would recover. The evidence relevant to that conclusion is set out elsewhere. Adopting these methods of recording values, understating the gravity of the problem in the 1984 Annual Report and 1985 Annual Review, and concurrently setting out to create profits through development activity, given Donald Cormie's state of mind, are evidence tending to show fraud and dishonesty on the part of Donald Cormie in the conduct of the business and affairs of FIC and AIC.

E. MATRIX INVESTMENTS LIMITED SHARE TRADING

INTRODUCTION

Matrix was a subsidiary of Allarco. Allarco owned 1,854,878 common shares, or about 63% of the 2,943,278 issued and outstanding shares. As described elsewhere, the authorized share capital of Matrix was substantially increased after its acquisition by Principal Group. The shares of Matrix were publicly listed for trading on the ASE and its shares did trade, although not in great volumes. [Exhibit 281]

Allarco had traded Matrix shares as early as December, 1985. A review of the evidence indicates that Allarco's trading was sporadic and that it did not purchase any shares on the open market (that is, on the facilities of the ASE) until January 22, 1986. Its purchasing activity continued in a sporadic fashion through to July, 1986. Thereafter Allarco — as well as PGL — became significant buyers of Matrix shares. The following figures are expressed as a percentage of all shares traded. In August, 1986 PGL accounted for 33.6% of the buys on the market and Allarco for 7.9%; neither company made any sales. In September, 1986 PGL accounted for 66% of the buys and Allarco made no buys. Allarco accounted for 15% of the sales. In October, 1986 PGL accounted for 56.2% of all buys and Allarco accounted for 3.05%. Allarco sold in that month slightly more shares than it bought, accounting for 3% of all sales. [Exhibit 596, Appendix B]

In November, 1986, excluding the large block transactions, Allarco accounted for 23% of all trading on the buy side; in December that became 90%. Allarco's buying activity continued into 1987 when it accounted for 84% of all buys in January; 48% in February; 62% in March; 87% in April and 72% in May. PGL then commenced buying, and accounted for 84% of the buying activity in June and approximately 65% of the buying activity in July. On the sale side, Allarco did not sell any shares in November, 1986; in December, 1986 it sold 4,000 shares, or 3.7% of the selling activity. In 1987, Allarco did not sell any shares. Similarly, excluding consideration of the large block trades, PGL sold no shares in November and December of 1986, accounted for 1% of all shares sold in January, 1987 and 2% of all shares sold in June, 1987 and sold no other shares during the period January through July, 1987. [Exhibit 596, Appendix B]

In terms of the number of trades made on the buy side, PGL and Allarco combined accounted for:

Month	% Of All Board Lot Trades
August 1986	43
September 1986	64
October 1986	38
November 1986	21
December 1986	84
January 1987	89
February 1987	44
March 1987	64
April 1987	85
May 1987	75
June 1987	80
July 1987	79

[Exhibit 596, Appendix D]

WHO TRADED THE SHARES

It was Robert Pearce who, starting in February or March of 1986, directed Allarco's trading in Matrix shares. He said he was the person directing the broker on the Allarco trades during most of the months from January to August, 1986, and continued to do so toward the middle of 1987.

The trades were made through Merrill Lynch. The financial consultant in charge, Muriel Meier, identified the corporate authorization to trade executed by Allarco. The officers authorized to conduct the trades were Donald Cormie, James Cormie, Robert Pearce and Emile Beaudry. The authorization was dated December 23, 1985 and the account was opened on December 24, 1985. [Volume 196; Exhibit 597; 7980-1]

Meier testified that Pearce placed the orders on the account. She could recall no other person doing so. She testified that Pearce's general practice was to place orders in 2,000 share quantities, although there could possibly be orders in other amounts. Merrill Lynch might fill that order on the same day, or it may have taken a longer period of time. Once the order was filled, frequently another order would be placed immediately. The orders were placed in bundles of 2,000 shares because it was thought to be the most practical quantity to enter at one time, having regard to minimum commission charges. Pearce was in the habit of calling her fairly frequently to obtain current information on Matrix trading: sometimes daily, sometimes more than once a day, sometimes every two or three days. From that he could determine the quote, being the bid and the ask; the last sale, and, the volume. Muriel Meier was also in the habit of "sizing the offer" by contacting the exchange to determine how many shares were available. From time to time she did that for Pearce. As Merrill Lynch became more frequent buyers, the Merrill Lynch floor trader in Calgary would notify Meier if a block of stock, generally 5,000 shares or more, became available for purchase, and that was also passed on to Mr. Pearce. When the orders were filled, Meier would advise Pearce of the execution, the price and the quantity.

Meier found the pricing very difficult to assess. Occasionally, she said, Pearce would meet the offer and there were also occasions where he would bid below the offer by a few cents. Both were "very common". She did not understand Pearce's instruction to be to bid at or below the last trade.

A bid refers to the amount offered by a potential buyer indicating the price the buyer would pay; the "ask" price is the amount at which a potential seller is prepared to sell.

Meier testified that Allarco did not buy any stocks other than Matrix through Merrill Lynch. It was explained to her by Pearce when the account first became active in early 1986 that the purpose of the account was to service a stock incentive plan wherein employees were reimbursed from time to time with shares of Matrix. He mentioned that Allarco wished to keep a bid in for a small quantity to "stabilize the market" and never indicated to her how many shares it wished to purchase. She denied ever being told that Allarco was attempting to provide some liquidity for that plan by purchasing shares. She interpreted the stabilizing function as having a bid into the market, being prepared to buy the shares, but not aggressively buying them. [36376-414]

Maude Warner, Meier's assistant, also testified. [36414-29] From early December to January, 1987 Meier was absent and Warner was caring for the account. She testified that with one exception, it was Pearce who placed the orders on the account. Sometime between Christmas, 1986 and mid-January, 1987, when Pearce was absent Stefanski placed the orders, and on occasion had mentioned that the decision had been made by James Cormie. In some instances, Stefanski would call to obtain a quote on Matrix shares, and state that she would discuss the matter with James Cormie and provide a decision later. She also testified there came a time when she began to receive larger orders than those traditionally placed. She noticed that change when Stefanski began placing the orders. That occurred at some time no later than December 23, 1986 and continued to approximately January 15, 1987. [Exhibit 616] Her evidence was that when Pearce returned and resumed giving the orders, they again decreased to approximately 2,000 share lots. She testified that her only contact with James Cormie was either on December 30 or 31, 1986 when he called to determine where the shares were held, and how they were being paid for. At that point, on his instructions, the account was changed to delivery against cash.

During Pearce's absence Warner inquired why the orders were becoming larger. Stefanski indicated in reply that "they were getting tired of placing smaller orders" and she "had indicated Jamie's [Cormie] name in that conversation as well".

James Cormie's evidence was that he did not give instructions with respect to bidding for Matrix shares except on Transactions #4, #10, #16, #17 and the Principal Employees Stock Plan. [14481]

Stefanski's evidence was that she was covering for Pearce during the Christmas holidays in 1986. She understood that Allarco was to buy in lots of 2,000 shares and to renew the order when the previous order was filled. She was unaware of the purpose of Allarco's trading and said she mostly only had to monitor the account. [7787-9; 7887-8; 15696-8; 22494-9; 22553-6; 22563]

According to this evidence, Pearce was absent during the time when some large block trades except Transaction #16 moved through the market. He was absent no later than December 23, 1986 and certainly on December 24, 1986. [7973] He returned and again commenced to trade Matrix shares on behalf of Allarco in mid-January, 1987.

PGL also purchased Matrix shares. It did so on 2 occasions; the fall of 1986 and the spring of 1987. The PGL purchases were said to be for the purpose of acquiring Matrix shares for the purpose of a bonus plan. The bonus shares were acquired on the open market in 1986 and 1987, notwithstanding PGL's control position in Matrix and ownership of millions of Matrix shares. Stefanski actually placed the orders. James Cormie testified that "probably" either Donald Cormie or himself would have instructed the market purchases [14479-81], and Stefanski testified it was James Cormie [15696-8] who instructed her, and who also made the arrangements with the broker. Stefanski only had to record the fills of the order. James Cormie told her to bid 5¢ below current offer and to always have a bid in. Appendix "C" to Exhibit 596 generally confirms that PGL's bids in 1986 and 1987 were 5¢ below the offering. In the spring of 1987 Donald Cormie instructed Stefanski to purchase the shares. [18728-9] Stefanski also stated that once, in September, 1986, Donald Cormie was critical of her for not having placed a bid for Matrix shares; that is, for allowing there to be a period during which there was no bid on the market. She also testified that he instructed her not to allow that to happen again.

PURPOSE OF TRADING

The Principal Group had established stock incentive programs. The first was established by PGL and in particular, Donald Cormie. [Exhibit 494] Donald Cormie said the PGL Board approved it and he carried it out. [21920] Under the plan employees were to receive a block of PNI and Matrix shares. Each Vice-President was to allocate blocks among his or her staff, subject to final approval by Donald Cormie. [Exhibit 494 at 1] The stock was to be escrowed; 50% released to the employees in November, 1986 and 50% in April, 1987.

There were no satisfactory explanations why PGL acquired the stock to fund the plan on the market. James Cormie said the reason was that PGL did not want to dip into its holdings nor change the share structure. [14481-7] Yet, in relation to Transactions #16 and #17 he said one reason Levesque was used was because it might sell some of the stock into the market. Donald Cormie said it was "normal" and "desirable" to have the transactions for this plan on the open market. [21939-41] It was desired so that there would be competitive, open-market pricing, to get the employees to feel they had a "fair shake" on the market and to get them interested in the stock. [21962] While the effect could be to support the price of Matrix shares, he said, that was not the intent. His evidence was that it was a PGL Board decision to acquire the shares on the open market. [21960-70] Yet, in 1985 PGL had funded the plan from its control block.

The second plan was established (nominally) by Allarco for key executives of Matrix. Under the plan, the executive would purchase Matrix shares from Allarco, and a proportionate amount on the market. Allarco would then match the number of shares purchased and charge them back to Matrix as a salary expense. The executive was free to sell up to 50% of the shares after 6 months; the remainder after 1 year. Allarco had a right of first refusal on any shares sold after the six month period. Pearce testified that Donald Cormie authorized this plan. [7986-9]

Pearce testified that the purpose of Allarco's trading was:

> . . . The discussions that I recall, at that time, were along the lines that the employees, as they get these shares, would be wishing to dispose of them and there should be somebody in the marketplace that would be willing to purchase those to offer liquidity to those employees as they placed them on the market. . . . [7981]

He continued: [7985-6]

> Well, as I mentioned earlier, the direction that I was given on the Allarco side of it was that [Donald] Cormie had indicated that there should be somebody in the market willing to pick up the Matrix shares when there is a significant quantity put onto the market, either through employees getting them out of their bonus plans and wanting to sell them, or possibly another shareholder. Basically, I was in charge of having Allarco be in the marketplace to purchase Matrix shares when that situation arose, and I would exercise some judgment on that. Normally I would pick them up at the market price that the shares were trading at, at that time.

He characterized [at 7990-1; 8441-9; 8465-72; 8481-2] the concept as Allarco being in the market place to provide some "stability" in the market for Matrix shares when employees or others sold shares and to provide "liquidity" by purchasing shares which the employees were selling. He continued: [7991-2]

> Q I don't understand what you mean by the liquidity to purchase them. Are you reflecting the price at which the purchase could be made?
>
> A Yes, I would set the price that Allarco would bid for those shares on the market.
>
> • • • • •
>
> Q . . . Are you telling us then, Mr. Pearce, that the trading by Allarco affected the price, the market price?
>
> A I would say that it, in the period of time where there would have been a lot of shares placed on the market and Allarco was purchasing some of those shares, it would have had the effect of stabilizing that price.
>
> Q Well, you mean by stabilizing, supporting it?
>
> A Well, yes, preventing it from falling down, that is right.

In terms of pricing, he testified: [7993-4]

> Q When you were doing the trading on behalf of Allarco, would you automatically meet the asking price when you purchased shares?
>
> A By that, you mean the asking price that the seller had put those on?
>
> Q Yes.
>
> A Generally, that's how the trade would be completed because that's what he would want to sell them for.
>
> Q Well, does that answer the question? Would you automatically meet the asking price?
>
> A No, not necessarily. As I say, an order might be in there and those 2,000 shares may have been purchased, say, relatively early in the morning, and if I was away for some period of time or even a day or so at a time, there wouldn't be another order go in. So it wasn't —

Q Well, would you put an order in at a specific bid price, then?

A Yes, I generally would do that.

Q What would determine your bid price?

A What the market was at, at that particular time.

Q So would you bid at or above the last trade?

A I would probably, if I was buying, I would probably bid below the last trade.

Similarly, Pearce said that "generally" his orders were placed at 5¢ below the last trade on the market. [8480]

Pearce testified under cross-examination: [8446-8]

Q How may employees' shares are we talking about that are going on the market and have to be given liquidity?

A I'm not sure exactly how many employee shares I would have bought in that program, Mr. White. But I do know that in the two years that the plan was in place, there was probably, including the stock bonus plan to the Matrix senior executives, there was probably in excess of a half a million shares out to employees.

Q How many employee shares were going on the market for which you had to, as you put it, provide liquidity?

A I wouldn't know specifically how many because they could be dealing through other brokers, and I would have no idea who —

Q And when were the employees going on the market with the shares for which you had to provide liquidity?

A I don't know. It was — it would be their choice, Mr. White.

Q How did you find out whether any employees were going on the market with shares for which you would have to provide liquidity?

A I would have just known generally that some employees were selling their shares —

Q How?

A Just through what I would hear around the office or whatever.

Q If you would hear a rumour that someone is going to sell some shares, and then you would go and make a purchase. Is that what you're telling me?

A No, that's not the case.

Q Well, what is the case?

A I would just be aware that some employees would be selling their shares.

Q Now, what was it that triggered the buy decisions, then, by you? Was it that you were aware that employees were going on the market with your shares? Was it a calendar date? Was it the phase of the moon? What was it?

A No, it was the general market itself. From time to time you would see a larger block of shares come onto the market, and being sold. I would have an order in to buy 2,000 shares at something less than what the last trade in the market was, and if somebody wanted to sell their shares and there was nobody willing to purchase them at that last trade price, it would probably fall down to the bid that I'd have in there for the Matrix shares.

Q If you didn't have a bid in there, then they may, on the market, have fallen even lower?

A Quite possible, yes.

Q Your whole reason for putting in a bid at the price at which you put in the bid was not because you were enthusiastically purchasing Matrix shares at a price you thought they were worth, but simply to keep the price from falling even lower on the otherwise unimpaired market, right?

A Yes, to see that the effect of a large block put on the market in one day would not adversely put the market down, and then have it pop right back up again, because that could very well have happened, too.

Q It could have, of course, just kept on popping down, too?

A If continuously large blocks were put on.

Pearce testified that setting up the plan for Allarco to purchase the shares was under the direction and review of Donald Cormie, and from time to time, he would come to Pearce if for some reason there was no bid on the market to purchase shares, wanting to know what was going on. He testified that in other cases somebody from James Cormie's department would come over and ask what was going on when there was no bid in the market. [8337-8] He also testified [7995-6] that he did not provide daily reports to James Cormie or Donald Cormie on the trades in Matrix, but that they had general knowledge of what was occuring from watching the market in Matrix shares, and had the ability to monitor the daily trades on the market themselves through the facilities of the PGL investment department.

James Cormie testified that he was aware that Pearce was buying Matrix shares "occasionally from time to time" [14458] for the purpose of stabilizing the price, which he defined as providing liquidity from time to time, at an amount below the highest bid. [14458-65]

Donald Cormie testified [18726-30] that he instructed Pearce to see what could be done about providing liquidity in the market for anybody wanting to sell, having started a program to have employees acquire the bonus Matrix stock.

Donald Cormie testified that Pearce was in charge of the price range and the amounts in respect of the Allarco trades. As did James Cormie, he testified that Allarco had placed orders from time to time, and he denied knowing that Pearce had something going all of the time. He testified, however, that it was important that Allarco always have a bid in the market in case an employee wished to sell his or her Matrix shares. He described the purpose as providing "liquidity", meaning if there were no bids for Matrix shares, Allarco would supply one, although he conceded that Allarco might buy even if there were other buyers. This function he equated to the market makers of other exchanges. [21927-47; 21969-76]

When initially instructed by Donald Cormie, Pearce consulted Patrick, the Principal in-house legal counsel. He said that Patrick told him:

> The specifics I don't recall. But generally, he said Allarco would have to, first of all, file as an insider on those transactions. Secondly, he would have said that you wouldn't have — you wouldn't want to be purchasing above the market on a daily basis at all. Your offers would be below the last trades out there in the market place. I think generally then he would say, he wouldn't ever be on both sides of the transaction, be the purchaser and the seller. [8451]

Patrick testified that he and Mr. Pearce "had a discussion about it". His evidence continues as follows:

Q Tell us about that.

A He asked about the rules and regulations with respect to an insider or a control group participating in the distribution and sale of the shares.

> I indicated to him about the reporting requirements, that he had to disclose when he intended to sell, and that he had to report when he sold or bought in accordance with the requirements in the Securities Act.
>
> The other area is not clear. I don't think there was any clear legal position with respect to the question of market support by an interested party. I know that on certain stock exchanges, that there are what are called market makers, which are brokers that are required to buy shares on the market, and they are there to support an orderly market. I probably explained that to him, that I was aware of that particular type of activity.
>
> I had had some discussions with our Toronto counsel about insider trading and trading from control blocks of stock, and that I was aware from those discussions that certainly the area was not clear and that the activity had to be handled carefully and in a reasonable amount. [8681-2]

The purpose of the Allarco trading was quite different from that of PGL. Allarco was said to be in the market to provide liquidity and stability. PGL was said to have made its purchases to fund stock bonus plans.

Rory Kidd was a floor trader on the ASE for Merrill Lynch and executed the orders placed on behalf of Allarco from March onward. While not called to give expert evidence, he had been a trader on the floor of both the ASE and TSE for some years and became a Registered Representative in early 1988. Kidd testified that he had no concerns with any of the trades at the time they were made.

His evidence must be placed in its proper context. He testified that Merrill Lynch has a compliance department, and if he heard nothing from Merrill Lynch, it would be his assumption that the trading activity was not any of his concern. However, he was not able to say whether he knew that their silence meant that the surveillance department did not pick up on the problem or whether it meant that it did not have a problem. He also testified that he was not concerned with Matrix trades because, at the time, the Principal Group was very well thought of and a powerful Alberta firm. He also agreed that it was not his function to conduct an investigation into whether the trading was proper or not and finally, he did not see anything happening in the market which would cause him concern.

As floor governor, Kidd initialed the Levesque large block transactions (Transactions #16 and #17, *supra*). He testified that at the time, he was not aware that Levesque had a contractual right to put the Matrix to an affiliate of PGL; nor was he aware that the execution of those agreements was guaranteed by a collateral account. However, he testified that as a floor governor, he would not be interested in knowing this information at the time because:

> 1. The trades were of a magnitude which would require a "compliance look-see" to ensure that everything was in order, and in his mind, those decisions would be made by compliance and surveillance personnel of the ASE and in Levesque Beaubien;
> 2. He relied on the fact that Levesque Beaubien had a compliance department, and on the fact that the ASE had its own compliance and surveillance department;
> 3. He assumed that if there was something wrong with the transaction the ASE would be aware;
> 4. He worked for a competitor and therefore, he did not consider it any of his business. [37699-70]

Kidd was asked whether the public might be influenced by a large block trade, and answered that such did not fall under his area of concern as floor governor. Kidd was not aware that transactions such as these are reported in terms of volume in newspaper reports. In any case, that fact would not concern him:

> It is simply not my job to be a Surveillance Department. I'm there to ensure that the trade is properly written. [37701]

That line of reasoning continued:

> THE INSPECTOR: That it is announced in a loud voice and the price and you don't care what the facts are behind it?
>
> A There are lots of other people whose job it is to ensure that that is correct or done properly.

He did say that if he saw something that "smells" [37702] he would bring it to the attention of those whose job it is to look after it. In the vast majority of the cases, he stated, he would not know what all the facts were and he did not conduct investigations. He testified that a trader is essentially an order taker. Kidd's lack of concern is not therefore of great weight in determining whether or not Allarco's trading activity was or was not proper. The inclusion of Kidd's evidence herein must not be taken as any criticism whatsoever of his own conduct. As he emphasized, he was not in the surveillance business. It was not his job to determine whether the trades were proper. [37698-706]

The brokers, Meier and Warner, also testified that they were not concerned with these transactions. There is no evidence that they were aware of the purpose of the trading in any detail, and in any event, there is very little evidence, if any, that the Principal Group and in particular, Pearce, relied upon these brokers to make sure that all was well. Indeed, Pearce was unable to remember Meier's last name, or the name of her assistant, Warner. [8439-40]

PRICING OF THE TRADES

Meier and Warner stated that there were occasions when Pearce met the offer and there were occasions when he bid below it. Pearce's evidence was that he "would probably" bid below the last trade, or "generally" placed his orders at 5¢ below the last trade.

What actually occurred in relation to placing orders is taken from detailed computerized records maintained by the ASE and detailed records maintained by Merrill Lynch. Based on that and other information, an expert report was produced and adduced into evidence. [Exhibit 596] Kidd said he found an error in the report. That must first be dealt with. The expert concluded that on December 2, 1986 Allarco increased the bid from $1.15 to $1.23 when the offering was $1.25. The new bid was traded against at 10:20 a.m. Kidd, upon examination of those same computer printouts, concluded that there was an error: the bid had not been increased from $1.15 to $1.23. Rather, he said, the input operator, by mistake, put the market in as $1.23 (bid) to $1.25 (ask). One minute and eleven seconds later, the market had been corrected and the bid showed at $1.15 and the ask showed at $1.23. From that, he concluded that Allarco in fact did not increase the bid from $1.15 to $1.23. [37688-92]

The seller sold the stock at $1.23. Allarco bought the stock at $1.23. The previously existing bid was $1.15. How did Allarco buy the stock at $1.23 if the bid was not increased? The answer is obvious. Allarco increased the bid. Confirmation can be found in Exhibit 616 at 20. The order ticket (which was filled out by the broker and reflects the order placed by Allarco) was time stamped December 2, 1986 at sometime after 10:00 a.m. and before the trade occurred at 10:23 a.m. The quantity or amount traded was 500 shares and the price was $1.23. Kidd did not identify any other portions of the report which he felt contained factual errors.

Kidd also noted that owing to the floor procedures there can be a delay in recording the timing of information. [37675-7] Kolosky, the expert, who testified first, said [34052-6] that he took into consideration the variance that was common, being a delay in the recorded trade time, compared to when the actual transaction occurred. He said that Matrix, fortunately, happened to be a fairly easy stock because of the thin nature and the domination of trading. He said there were no more than 10 or 15 trades about which he was concerned. Kolosky also testified that he had familiarity with the ASE floor procedures.

Accordingly, Kidd's concern over the accuracy of the report is not of concern.

Pearce may have commenced bidding below the last trade. But a review of Exhibit 596, Appendix A shows that Allarco's purchases were made mostly at an amount equal to the last trade (which last trade became more and more an Allarco trade). Occasionally Allarco bought at an amount exceeding the last trade and in a slightly lesser number of instances it bought at an amount less than the last trade. In order to make trades at an amount equal to the last trade, Pearce's bid must have been equal to or in excess of the last trade, since he can not pay more than he bid.

In relation to Pearce's evidence, Kolosky stated under cross-examination by Pearce's counsel:

> Q Now, Mr. Pearce has given evidence . . . that in the instructions that he provided for the acquisition of Matrix shares, he instructed that they be bought at a price at or below the last trade. Is that your understanding of the instructions that he was providing?
>
> A I saw that comment several times in the testimony, yes.
>
> Q Alright. And I take it that there are trades that you have observed that occurred where they appear to reflect those kinds of instructions?
>
> A There are a few. The preponderance of them do not appear to reflect that instruction. [34169]

Counsel for Pearce submitted a schedule to their argument purporting to demonstrate that Allarco bid below the market price. Considering the period November 1, 1986 to June, 1987, and excluding days where Allarco did not buy shares (the schedule includes trades made by others who used the same broker as did Allarco), it can be seen from Exhibit 596, Appendix A that Allarco usually made purchases at amounts exceeding the bid as shown in the schedule. It may be that bids in the amounts shown on the schedule were made on those days. They might not have been those of Allarco, and they are inconsistent with the amounts at which Allarco actually bought stock.

It is a fact that Pearce usually bought, during the months of November, 1986 through June, 1987 at an amount equal to the last trade, and occasionally upticked the stock to a higher price. That would require him to bid (or increase his bid) to that same amount.

EXPERT EVIDENCE

Kolosky Opinion

John Kolosky was called as an expert witness before me to assist in assessing the effect of Matrix share transactions.

He was qualified as an expert on what sort of conduct constitutes manipulation of a stock market.

Day to Day Trading Activity

Kolosky's conclusion can be expressed as evidence tending to show that for the period December, 1986 to July 15, 1987 the trading by Allarco and PGL eliminated an independent public market where the prices would have been established by several investors negotiating at arm's length; that the price leadership and destabilizing trading activity carried out by Allarco and PGL moved the market up to a level that did not reflect a public opinion of value for Matrix shares; that the effect of the trading was to create a false impression of public market activity; that the price was moved so substantially on a few occasions that the effect was to cause an increase in the market value of the control block holdings of several million dollars; that every 10¢ increase in value in the price of Matrix shares would produce approximately a $6,000,000 change in the market value of the control block, which was composed of approximately 61,000,000 shares; and that the dominance of the trading in many instances influenced all subsequent share trading and the price mechanism. [Exhibit 596; 34008-15]

Kolosky concluded that during the first months of 1986, from January to July, the share trading did not appear to unduly influence the market for Matrix shares. During this time, Allarco supplied shares to the rising market, which was in his opinion an appropriate function. With this level of interaction between independent arms' length investors, the market had the opportunity to reflect a public market price. The market ranged from $.70 to $1.30. [Exhibit 596; 34034-5]

From August to November, 1986 there was a reverse of the previous net seller situation. Kolosky concluded that the excess of buying over selling by Allarco and PGL significantly influenced the market and was the beginning of the dominance of the market, especially on the buy side, by Allarco and PGL. He noted that on several days, the buying was completely dominated by Allarco or PGL and, as such, the market price became less a reflection of the decisions of independent arm's length investors and much more the price determined by Allarco and PGL. The share price ranged from $.95 to $1.34. His conclusion is evidence tending to show that PGL, between August 27, 1986 and October 14, 1986, caused the stock price to move up from $.95 to $1.30. [Exhibit 596; 34035-9]

His conclusion is evidence also tending to show that from December, 1986 to July, 1987 extreme undue influence over the market for Matrix shares was exerted by Allarco and PGL. This extreme undue influence and domination caused the public influence on the market for Matrix to be virtually non-existent. The share price was raised and an essentially non-public market was created. He noted that the buying, in volume as well as in the frequency of trades, was so substantial that the market for Matrix shares was essentially devoid of public influence on the buy side. [Exhibit 596; 34045-6; 34058-61; 34064-78]

Kolosky was able to identify numerous instances where Allarco met an offer that was placed in an amount in excess of the last sale price and even, in some cases, maintained a bid at that new level. In particular, on December 3, 4, 8, 22, 23, 24 and 30, 1986 Allarco purchased shares at amounts in excess of the last sale. He opined that in December Allarco increased the price of the stock by 18% through its buying. [Exhibit 596]

Kolosky concluded that these sorts of examples amounted to — and his conclusion is evidence tending to show — price leadership by Allarco which moved the market in a fashion which was not consistent with providing liquidity. He pointed out that the only legitimate intent or motivation for buying is either as an investment or to provide liquidity. He concluded that one purchasing for investment purposes might attempt to accumulate the shares at as low a price as practicable without losing shares to other buyers. Yet his review of the trading did not indicate during several periods of time any real competition on the buy side of the market that would have caused Allarco to increase its bid. He pointed out that if Allarco were buying the shares for the purposes of providing market liquidity, its bids should have been supportive, such as a bid below the market rather than at offering prices. [34058-9; Exhibit 596]

During January, 1987 in his opinion the dominance and control of the market by Allarco continued. He concluded that the price was created and maintained almost exclusively by non-public buying by Allarco and noted that the Principal Group employees' account (which was assumed to be a part of the public float [34241]) was bidding even higher than Allarco to buy the shares, thereby establishing a new high in trading for the month. He concluded that the public was not a factor in the buy side of the market. There was no reasonable public indication of the value of Matrix shares. He noted that the continuous $1.45 bid by Allarco caused five other buyers, other than purchases made on behalf of the PGL employee account, to bid higher and pay $1.50 to obtain shares. He concluded that this conduct certainly did not provide liquidity. Rather, accepting Kolosky's opinion, the evidence tends to show that this conduct created a market for the Matrix shares, and prevented the price from falling below $1.45 per share. [34059-60; Exhibit 596]

From February 1 to 13, 1987 Allarco remained in the market, purchasing 61% of the shares that traded. It held the price at $1.40. Kolosky noted that during February there were again instances where Allarco purchased shares at amounts exceeding the last sale, and others where it met the offering price. [34060-1; Exhibit 596]

Allarco stopped buying Matrix shares during the period February 17 through 27, 1987. The price fell steadily from $1.40 to $1.25, although in Kolosky's opinion previous activity by Allarco would exert a continuing influence on the market. [34061; Exhibit 596]

From March 1 to 10, 1987 Allarco did not purchase any Matrix shares. The price fell to a low of $1.10 reflecting, in Kolosky's opinion, a share value determined to a greater extent by public and employee bids, but still influenced by Allarco's previous high bids and purchases. [34061-2; Exhibit 596]

On March 12, 1987 Allarco began to buy at $1.45. After a bid by the PGL employee account, which brought the price to $1.50, Allarco held it at that price for the remainder of March 12 and during the morning of March 13, 1987. The large block trade (Transaction #10, East/West #3, *supra*) was then printed at $1.60, once Allarco had taken out the better offerings in the market by purchasing Matrix shares at $1.55 and $1.58. Kolosky opined that Allarco's activity prepared the market for that large block, and that the printing of the block trade appears to have had an influential effect on the market. Trading on the following day, by mostly unrelated parties, brought the stock to a new high of $1.75, with no trades less than $1.60. On March 17, 1987, the market began to fall until Allarco placed buy orders of $1.55 in an effort to hold the price. Nonetheless, the price of Matrix shares fell to $1.45 by the end of the day. [34067-8; Exhibit 596]

From March 18 until March 25, 1987 Allarco again became the dominant buyer and prevented the stock price from falling below $1.55. On March 26, Allarco bought at $1.50. It resumed its buying and prevented the price from falling below $1.50. Kolosky concluded, and thus there is evidence tending to show, that these actions prevented the market from reflecting an independent public opinion of value. Instead it was showing a price determined by Allarco. During that time, March 18 to 31, 1987, Allarco bought 86% of the shares traded. Kolosky noted, by way of example, that during March, 1987 there were again instances where Allarco met the offering price and then increased its bid. [34069-71; Exhibit 596]

The evidence tends to show that during April, 1987 Allarco's dominance of the market continued. From April 1 to 7, Allarco's buying prevented the price from falling below $1.50. For some reason, between April 8 and 13, 1987, the price fluctuated between $1.40 and $1.50 with Allarco being the dominant buyer. From April 14 through 30, 1987 Kolosky concluded that Allarco's dominance generally prevented the price of Matrix shares from falling below $1.45. It bought 83% of the shares traded on the ASE during the month of April, 1987 and continued to prevent a public market for the shares of Matrix from developing or existing. [34070-1; Exhibit 596]

During May, 1987 the evidence tends to show that Allarco prevented the price from falling below $1.45 until the last few days of the month, when Allarco's buy price was reduced to $1.40. It purchased 72% of the Matrix shares traded on the ASE that month and again, the evidence tends to show, continued to foreclose a true public market. Allarco did not reduce its bids while purchasing the shares which would have allowed the market to find a level where the public felt the stock had value. [34071; Exhibit 596]

During the month of June, 1987 purchasing by Allarco ended. Again, the price of Matrix shares after Allarco ceased its market activity (June 8 to June 16, 1987) fell to around $1.20. PGL then commenced to buy, dominating the market through its purchases, and moving the price back to $1.55. PGL continued to buy almost 100% of the shares sold for the remainder of June, 1987, moving the price up to $1.55. Between June 17 and 30, 1987 PGL purchased 99.8% of all the Matrix shares that traded on the ASE. [34071-4; Exhibit 596]

PGL bought 91% of the Matrix shares traded on the ASE from July 2 through 15, 1987. From July 16 through 31, 1987 the share price fell to $1.05 from a high of $1.45 without the influence of Allarco or PGL. By the end of August, 1987 the price had fallen to 70¢. In Kolosky's opinion, some of the fall in price could be attributed to the failure of FIC, AIC and PGL, but without the influence of Allarco and PGL the price would not have risen to the levels it did in the first instance. [34074; Exhibit 596]

Kolosky concluded, and thus there is evidence tending to show, that from December, 1986 to July, 1987 there was a non-public market where the share price of Matrix was forced up by Allarco and PGL. Orders were given to buy at prices above the last sale, which in turn forced market prices upwards. He noted that bids below the market price (last sale) would not have increased the price. [34075-6]

Kolosky defined destabilizing trading as a trade made at a price exceeding the last differently priced trade. He noted that from January to July, 1986 Allarco and PGL did not appear to have actively conducted destabilizing trading. He concluded that there was a 14% destabilization rate, which was not offensive for a thinly traded stock. For the period August to November, 1986 the destabilizing trade rate increased to 64%, and for the period December, 1986 to July, 1987 the rate was 77%. [Exhibit 596]

This aspect of his analysis was not well received. Kidd, for example, testified that the concept of destabilization did not apply in Alberta; while the bylaws of the Alberta Stock Exchange define stabilizing and destabilizing trades, and provide that "registered traders" would be restricted in making destabilizing trades [Exhibit 594], no persons had ever been designated registered traders on the Alberta Stock Exchange. [37679-81] Callaghan, another expert, confirmed that the concept was not of general application on the ASE. It was Pearce himself who testified that he sought to stabilize the market and to provide order to it.

Kolosky testified that no market — whether junior or very senior — is ever so efficient that there is always a continuous two-sided market, showing a bid and an ask. Therefore, intermediaries are permitted to act in a stabilizing fashion to promote order in the market and to remedy temporary imbalances of orders that are placed. The intermediary's function comes into play when supply and demand starts to change. With selling pressure in the market and no other buyers, the intermediary would place a bid and if he determined that he was the only one buying, he would most likely reduce his bid in steps to allow the market to fall in an orderly fashion. That price movement information is disclosed through the quotation system to the industry. At some point, the public starts to buy. The intermediary drops his bid until there are buyers. [34023-34] Kolosky said:

> There's nothing preventing him from buying some, but if it goes on for days and weeks and months, there's something unusual. That market is not reflecting the public market price, it's reflecting the price that the intermediary wants to put on it, in the position of an intermediary that's not his function. . . . [34026-7]

Kolosky noted that if the intermediary thought there was a good opportunity on the stock and that the market would move up substantially, he is allowed to buy because he is there to make a profit. [34027-8] Kolosky considered that the concept of destabilizing trading was important when assessing a fair and orderly market:

> . . . destabilizing trades ties directly into maintaining a fair and orderly market. You're not running an orderly market when you're inputting an excessive amount of destabilizing trades because by definition a destabilizing trade is adding to the movement. It adds to the disorderliness. [34029]

He said that the function of the intermediary is to moderate or cushion the effects of supply and demand in the market place. If the imbalance appeared more than temporary, the price should drop or increase without interference by the intermediary:

> If the vast majority of the orders coming into the market are to sell, he certainly is not expected by any stretch of the imagination to stand there and buy all the shares that come in. You would expect him to allow it to move to the new level. . . in an orderly fashion . . . . [34029-30]

Kolosky also said that this sort of function was limited to the short term:

> If you're not in there for the short term to provide liquidity, to provide orderlyness [sic] in the market, you're not performing that function. By definition, that function is a short-term function. If you're holding a stock at a price to the same extent as if you're moving a stock up, if you're allowing your trading to be the determinating [sic] factor on the price level for that security, you're not operating as an intermediary, you're operating more from an investor point of view, and then you're looking at the situation in a different light . . . [34031]

In Kolosky's opinion, any prolonged dominance in the market by an intermediary, even at specific, technically stabilizing prices, does not contribute to an orderly market and is manipulative. [34032-3]

Kolosky testified [34079] that the concept of destabilizing trading was another way to consider whether a market manipulation had occurred:

> . . . When you look at destabilizing trades you can see very clearly to what extent the activity of the participant has caused the market to move up or down.

He acknowledged that because Matrix stock was a more speculative stock and traded on a thinner float, a greater level of destabilization — such as 14% — would be acceptable. In relation to Allarco, he opined:

> . . . with Allarco's activity, any party who is purporting to be providing liquidity or orderly markets must also accept the responsibility of not destabilizing or unduly affecting the market. You can't be indicating that you're in there to provide liquidity and then act in a fashion contrary to that activity. [34087-8]

In his opinion, and thus there is evidence tending to show that, Allarco's activity including and after December, 1986 exerted an undue influence on the price of the Matrix stock. [34083]

In relation to whether the concept of destabilizing trading applies on the ASE, Kolosky testified under cross-examination: [34189-90]

> Q Are you suggesting in Alberta where they don't have registered traders that those rules would be expected to be applied by people conducting trades on behalf of someone who is not a registered — the person that is initiating them is not a registered representative, but is doing it for the purpose of maintaining the market?
>
> A Certainly when doing a trade as an issuer bid or under a distribution, yes, I would expect it to be applied. Doing a trade where the party was aware that the account was, you know, effectively maintaining the market, let me say most probably not, except the effect of destabilizing, you know, should be recognized over a long period of time by the people receiving the shares, if they are aware that that party is, in fact, attempting to maintain an orderly market.

He continued:

> Q . . . Do you suggest that it is in any way objectionable for a broker or brokerage house to carry out an instruction to acquire a share on the market at the market price?
>
> A No, that's not objectionable in itself, looking at that as a single transaction. The basic reference to stabilizing, destabilizing trades in the report that I have submitted is an attempt not to say that that aspect of the Alberta Stock Exchange as being violated, but to demonstrate through that concept which is applicable in many sections of the rules and legislation affecting security markets that when you do a preponderance of

> destabilizing trades it creates a domino effect on the marketplace and that's the reason why when you are involved in a distribution or you're doing an issuer bid et cetera, that they are prohibited.

Kolosky also pointed out that if the stock trades at a certain amount, and then is upticked to a higher amount, all such subsequent trades at that same higher amount are destabilizing pursuant to the definition. He added "As long as the trade is at a price that is below the previous differently priced trade it is stabilizing." [34191]

This evidence raised the issue whether Allarco conducted any destabilizing trades at all. Quite often, the odd intervening public buyer upticked the market. Allarco would continue to buy at that price or at a lower price. Under cross-examination by Mr. Kenny, counsel for Donald Cormie, James Cormie and John Cormie, the witness agreed that a number of trades by Allarco were technically stabilizing because Allarco continued to purchase at a certain price, with a small number of buyers interspersed throughout who had purchased at higher prices. Therefore, when Allarco continued its trading at the same price, its trades were technically stabilizing. It is therefore the case that, for example, during the entire month of January, 1987 the preponderance of trades made by Allarco were technically stabilizing. However, on p. 18 of his report and during his *viva voce* evidence, Kolosky indicated that any prolonged dominance in the market by an intermediary, even at a specifically technically stabilizing price, would not contribute to an orderly market and was therefore (and thus the evidence may tend to show) conduct which was improper and manipulative. Kolosky testified that that literal definition is not normally applied. Kolosky said that his characterization of a trade as stabilizing or destabilizing [34244] went as follows:

> It would depend on the nature of the trading and the frequency with which they were trading at higher prices that appeared to be independent. So that if there was a substantial amount of trading at higher prices, then they were buying lower, those lower transactions were considered to be stabilizing. The evaluation is based on the nature of the transactions in affecting the marketplace so that when there was an abundance of buying at higher prices and then Allarco was supporting at a lower price, those transactions at a lower price would have been calculated as stabilizing.

Kolosky reiterated why he had used this technique: [34246]

> . . . So in evaluating the marketplace for the effect of their trading on the market price, you know, the destabilizing technique was used as a technique to evaluate the market and to be able to project the effect in a more clear fashion. And in looking at the market place, you know, there is no doubt in my mind whatsoever that the continuous purchases at those higher prices, you know, were manipulative. So that the stabilizing technique is to demonstrate the effect.

Large Block Trades

The so-called large block trades were described in the section of the Report entitled Certain Significant Transactions (Transactions #10, #16 and #17). Kolosky opined and his opinion is evidence tending to show that none of the large block trades should have been transacted through the facilities of the market and could discern no reasonable business purpose for carrying out these trades in the manner in which they were completed. [34088-92; 34286-7; Exhibit 596]

In relation to Transaction #16 (November 20, 1986 and December 22, 1986), Kolosky testified that he could discern no reasonable business purpose for the transaction. If there were a legitimate business intent to take the block over the floor of a stock exchange, it would be permitted. Having regard to the structure of the transaction, the fact that very few shares were sold into the market place, absent an indication that there was any attempt to effect a distribution or to recommend the stock to clients, and considering that the primary purpose was not to effect a wide distribution, he concluded and his conclusion is evidence tending to show that the block shares should not have crossed the floor. In his opinion, moreover, the market was prepared and maintained for this transaction by Allarco's trading. [34096; Exhibit 596]

Kolosky noted that after the large block was sold, the amount of non-insider buying increased. During this time, the price declined, at which point Allarco resumed purchasing and upticked the stock to $1.30, and then held the stock at that price almost exclusively from December 8 through 22, 1986. [34096; Exhibit 596]

With Allarco's bid at $1.30 on December 22, 1986, the market was $1.30 bid to $1.35 offer. This enabled the trade resulting from the exercise of the put and call option at $1.31 to appear to be within the normal market range. [34096-7; Exhibit 596]

Another large block trade (Transaction #17) was executed on December 24, 1986. From December 22 to 24, 1986 Allarco continually increased its bid from $1.30 to $1.45, which was traded against, causing the market to move up. The market prior to the block transaction was $1.45 to $1.50. With Allarco buying the shares up from $1.35 to $1.45, the large block cross at $1.50 appeared to be within the market. While it would not be necessary to trade the stock within the market range (because it was a cash settlement transaction), it did appear that the block was trading within the current market price. [34100-1; Exhibit 596]

Kolosky testified that although there was some price flexibility in placing these blocks across the floor of the ASE because they were cash transactions, there was some benefit in crossing them at an amount closer to the market price: first, it ran a better chance of being approved by the floor governors; secondly, it gave the impression that the trade was occurring within current market prices. [34102-3]

Kolosky opined and thus there is evidence tending to show that these were simply warehousing transactions and should not have moved across the market; rather, these transactions gave a false appearance that the market could handle large block transactions at the high price levels created by Allarco, and was simply another aspect of market manipulation. Kolosky pointed out that unlike Levesque's role in Transaction #16, East West Investments in this transaction could not reasonably be expected to effect a secondary distribution and pointed out that the deals were structured to give a guaranteed rate of return. They were financial transactions, not investment transactions. One might also note that like the Hunter Transaction (#10), nothing compelled PGL to cross the East/West blocks over the floor of the ASE. [34103-6; Exhibit 596]

The final large block transaction was executed on March 13, 1987 (Transaction #10, East/West #3). From February 17 to March 10, 1987 Allarco was not active in the market. The share price declined to a low of $1.10, with a last trade price of $1.20 and a closing bid of $1.10 to $1.25. On March 11, 1987, a purchaser upticked the price to $1.40. On March 12, 1987, Allarco resumed purchasing Matrix shares and upticked the price to $1.50. On March 13, 1987 Allarco again was the only buyer, upticking the stock to $1.58. It took out the offer at that level at 9:09 a.m. and at 9:18 a.m. the large block was crossed at $1.60. The market then became $1.55 to $1.60 immediately afterwards and Allarco continued to buy shares at the $1.55 level. [34103-6; Exhibit 596]

Kolosky opined that Allarco prepared the market for the cross of the large block of Matrix shares. Again, his conclusion may be evidence tending to show that a false impression was created that the market could handle large transactions at high prices and for the same reasons as previously stated, the trade should not have been executed in the public market. [34104-6]

Kolosky acknowledged that a broker would be aware that these trades resulted from large block transactions, but that it would be reasonable for a broker seeing that transaction occurring to speculate that something was developing with the stock. Such trades in themselves were considered significant and usually are indicators of some subsequent activity. [34113-5]

Under cross-examination Kolosky testified [34273-81], that a buyer or seller watching the stock would normally make inquiries of his broker about large block transactions, and the broker might similarly make inquiries. Kolosky again testified that in the case of a thinly traded stock, the large transaction would generally be regarded as a signal of something special developing, and agreed that the news could be taken several ways. It is not definite that it would be considered a negative factor, nor a positive factor.

Stock Bonus Plans

Kolosky testified that the stock bonus plans had the effect of reducing the public float. The Matrix executive plan required the executives to purchase Matrix shares to entitle them to a bonus of additional Matrix shares, and the control group of Matrix retained a first right of refusal on selling those shares. As a result the shares were effectively removed from the public float. [34076-7]

The PGL plan had no such restrictions. But the shares bonused to PGL employees were purchased entirely in the market during 1986 and 1987. That reduced the public float. If PGL's goal was to increase that float, distribution from its immense control block would have been the most efficient course of action. Instead the purchase of Matrix shares in the market simply caused a temporary redistribution of the public float as Allarco continued to repurchase the shares from the employees. The public float was reduced, the shares were circulated to employees, and again repurchased by PGL or Allarco. Some 48.8% of all Matrix market activity from January to July, 1987 was generated by the stock bonus plans in Matrix. [34077-8; Exhibit 596]

Callaghan Opinion

The only other expert who gave evidence in this area was Thomas Callaghan, called by counsel for Pearce. Originally the witness was tendered as an expert to offer the opinion that there cannot be expert evidence given on market manipulation. [37732] He was later permitted to give evidence on indicia of a market manipulation.

Callaghan testified that price and volume were two considerations in assessing manipulation. In his opinion, the price range from July, 1986 to July, 1987 would not indicate that there was "necessarily any kind of manipulation going on". [37774] He stated that in 1986 the Principal Group of companies was very substantial, certainly as far as the ASE was concerned. He said that might assuage any concern and that was a factor that had to be taken into consideration. He said that the increase in price from January to December, 1986 might be explainable by Matrix's acquisition of the brewery and the oil and gas properties, which were negotiated in September, 1985 and consummated at a shareholders' meeting sometime in the new year. Moreover, the markets were active. He conceded, however, that considering the price increase alone was not helpful unless one knew the facts that caused the price to go up. [37772-82] Callaghan testified that there were additional indicia of market manipulation, none of which fit these facts. [37794-8]

It should be noted that Donald Cormie gave evidence that activities took place in Matrix over 1986 that could account for the rise in value of its stock, including the development of Drummond Brewery, certain oil and gas discoveries near Edson, Alberta, and the development of a program to acquire other assets for Matrix. [18732-39; Exhibit 461]

Callaghan testified that while the price and volume of Matrix trades would not cause him concern and did not indicate a manipulation [37758], the exception was March, 1987. He said:

> But going over the year, going from $1.45 as the opening at the beginning of the year and hitting a high of $1.75, and that happened in that short period of time, that I think would have caused me to ask some questions. [37780]

Callaghan gave evidence on the practice of companies providing liquidity to the market. Callaghan indicated that he had reviewed Pearce's evidence on this point and stated:

> Well, there was discussion in there also about the employee bonus plans, employee and executive bonus plans and providing a market for them to liquidate their shares. That is not unusual for companies that do have bonus plans or share purchase plans type things with their employees. [37763]

Callaghan indicated that there would be a number of reasons why a company may purchase shares which had been bonused to their employees:

> Some kind of support on the likelihood that a fair bit of that stock would end up back in the market and consequently, to have a market there to absorb them.
>
> Certainly I think the company would have to feel some obligation if these shares are being bonused or in some way given to the employees, they'd present them with a tax problem. As I understand my limited understanding of tax law, that an individual receiving those shares would have to account for them as income at the market value at the time. And consequently, if the market decreased from the time they received them, then not only would they be saddled with having to claim the market value as income, they would end up having a loss on the sale of the shares.
>
> So I think the company, understandably so, would feel some obligation to make sure that there was a market there to absorb any of the stock that might come back into the market. [37764]

Callaghan could not say if this activity was improper:

> It's done, and it seems the fact that it is done and I haven't heard of any prohibition of it or condemnation of it. There may have been, but I haven't heard of it. [37765-6; and see 37819]

He testified that there would be nothing wrong with providing some stability to the employees who were bonused the stock, and questioned whether the public would be hurt by this activity. The public was probably being assisted; if they wanted to sell, there was a good market and solid bid to which they could sell. [37784-5] The objective of providing liquidity would be legitimate if it was not unduly affecting the market price. [37785] He saw no indication of a manipulation during January, February and March 1 to 12, 1987, inclusive. He pointed out that through January, 1987 it appeared that Allarco kept a bid in the market to pick up the stock at $1.45, and going into February, Allarco maintained the price at $1.45 and then dropped it to $1.40. That was not an indication of manipulation; keeping in mind the purpose of the trading, the stock price was quite "stable". [37785-91]

Callaghan testified that large block trades were not unusual on a stock exchange, although there were few in Alberta due to the nature of the ASE as a market. They occurred from time to time, but they were not frequent. [37801-2]

Callaghan was asked whether the nature of the large block transactions should have been disclosed to the public. He answered that it must have been disclosed to the surveillance people within Levesque, and in the case of the East/West deals, Levesque was the broker and he would expect that brokerage house's compliance department to be aware of the transaction. Then he stated:

> Here again, I think that you've got to go back and put things in historical prospective. Hindsight is great, but the public certainly wasn't aware. And the stock exchange had no way of knowing that there were problems in the Principal Group. [37807]

It was then put to him that the public would have no way of knowing about the put call agreements attached to these transactions, and Callaghan was asked whether, as a director of the ASE, he would want the public to see large trading volumes without disclosure of this additional information. The answer was:

> I'm not sure that there is anything illegal about that. I don't know, I'm not a lawyer. [37808]

Again the question was put. Then the answer was:

> Well, I can't answer that for the exchange because I was not in that area at the time. [37808]

Finally, after reviewing the information, Callaghan was asked whether it was his opinion whether he found indications of anything showing contravention of ASE Bylaw 11.26. The answer was:

> I would go so far as to say it would be difficult to prove from this information. Whether there was manipulation or not, I can't say. [37809]

Earlier, he had stated that manipulation is:

> . . . a difficult thing to prove because the concept of intent enters into it, and it is awfully difficult to get into another person's head and prove what their intent was. [37730]

He concluded by testifying that he could not, based on following the trades, come to a positive conclusion whether a manipulation had occurred, but could not state that no one else could reach such an opinion. [37809]

Under cross-examination [37810-17] Callaghan acknowledged that the more people involved in the market, the less likely is the action of any one person to affect the fortunes of everybody else in the market on that particular stock. His testimony included the following:

> Q And, indeed, you said that stabilization in and of itself is not evil because it ensures that the buyers and the sellers in the market do not wake up tomorrow morning and see that there's no market?
>
> A Well, even under the registered trader procedure, I mean, they're obligated to come up with bids and acquire some stock on the way down; to come up with offers and sell stock on the way up. If they weren't there, where would the stock go? Is that manipulation?
>
> Q I'm not suggesting it is, sir. If they weren't there, where would the stock go, there would be no market; is that right?
>
> A There could be a market, but you would have humungous gyrations, you could have. But the fact that they intercede and ease the market down or ease it up helps to contribute to an orderly market.
>
> But you can ask yourself the same question Mr. Code raised earlier their involvement in the market. They're not in there really to become shareholders, they're in there to take out the humps and the valleys in the market. But is that the real market? I don't know. Where would it go if they weren't there?
>
> Q Sir, their function is to cushion or moderate the price movement?
>
> A M-hm. Is that a form of manipulation?
>
> Q You're the expert, tell me.
>
> A I don't know. There's so many things that could be looked upon as manipulation.
>
> Q Sir, do you accept that intermediaries, informal intermediaries exist and their function is to cushion and moderate the price movement?
>
> A They exist. But because of regulations the way they are today and the super regulation we have, it's a negative thing to refer to any member of the public or that as running a box on a stock. In the early days of the mining business in Ontario, the promoter ran a box on the stock. Everybody knew who he was, the exchanges knew who he was, and the selling came in, or buying came in, he was looked upon to help smooth the thing out. But that has become kind of a negative thing.

> So consequently, the principals of the company will find ways that they can go in and help to stabilize the market. If they do it themselves, then they've got to file Insider Trading Reports and all the rest of it. So usually they will make some arrangement.
>
> I still believe quite strongly in my mind and from my experience that many, the majority probably, of markets and stocks do not happen by accident by the normal ebb and flow of buyers and sellers. That role and some of the major stocks has been taken over by the specialist traders in New York, by the registered traders. It doesn't just happen, because if it was just the normal ebb and flow of buyers in the market, we would have all kinds of ups and downs in the market.
>
> Some of the best markets are markets that I know are being maintained.
>
> Q Sir, you told Mr. Champion, as I recall, and I may well be wrong, that there's nothing wrong with setting out to stabilize the market because it protects the public who also invest in that market?
>
> A Referring right here to the same case with Allarco acting as in intermediary?
>
> Q I'm talking about intermediaries generally.
>
> A Generally? Basically that's what the registered trader is, is an intermediary.
>
> Q And, sir, it's done informally on the Alberta Stock Exchange?
>
> A M-hm.
>
> Q And the function of those people, sir, is to moderate or cushion the movement in price; is that right?
>
> Q Yes.
>
> Q So if the informal intermediary determines that he sees no competition on the buy side, sir, then should he not expect the price to drop and, therefore, he ought to drop his own bid and perhaps gradually?
>
> A If he sees no competition on the buy side?
>
> Q Yes, sir.
>
> A He could drop it. If he was trying to promote it, he would be moving it up.
>
> Q Sir, if there's no competition on the buy side, the price ought to drop, ought it not?
>
> A Normally it should, yes.
>
> • • • • •
>
> Q If the price ought to drop . . . because there aren't any buyers for the stock, then if he maintains the price at the same level, sir, then has he not created a market that no longer reflects the normal forces of supply and demand?
>
> A Well, maybe he's prepared to take a stand there and stabilize the market there. And if somebody wants to sell, John Q. Public wants to sell, he'll pay that price for it rather than drop it back lower and pay them less.

Callaghan acknowledged that as long as a dominant buyer decided to remain in the market, there was normally no problem for the public. He acknowledged that if such a buyer accumulates a large amount of the stock he acquires a vested interest in not having the price drop.

At pages 37823-4 Callaghan raised what he felt to be the main motivation for the transactions:

> Q Well, sir, is it an indicia of manipulation that when the dominant buyer is out of the market the price goes down, but when the dominant buyer is back into the market, the price either goes up or remains the same?

A Usually if he is getting ready to promote the stock, then the usual procedure would be to start lowering the bid to accumulate the stock as cheaply as you could, and then start the promotion and sell it as high as you can.

Q That's right. Except what if they already own 59 million of it in their Treasury. They don't need to accumulate it on their market, do they?

A No, they don't. They've got it, that's right. Whether these are employees coming back in or not, I don't know. I don't know what was in their thinking as pertains to the market itself. I think I have an idea what they want to do in the overall picture. That's my own opinion.

Q Well, does that opinion relate to creating gains on financial statements, sir?

A Yes, gains that can be reflected in the financial statements, not just on a note.

Callaghan opined that he could not determine management's intent. If management intended to manipulate the market, Callaghan said, they would have taken a "real run at driving the stock up to 3, 4, 5 bucks", which on a financial statement, might just have solved a lot of problems. [37825-6] Upon being asked whether $1.50 might be sufficient for the profit that management needed, he replied:

> That could very well be. But here again we're getting into intent. [37826]

Finally, Callaghan testified as follows: [37832]

Q Sir, are you here to say today that Mr. Kolosky is not necessarily wrong --

A No, I'm not saying he's wrong.

Q But that --

A I'm expressing an opinion, which, in some cases, is at variance with his.

Q You would agree that it is quite possible that there was manipulation except that you're not prepared to give a conclusive opinion?

A No, I harken back to something that I read in the transcript, and, Mr. Code, everybody agreed. Intent.

Q Yes, sir, intent.

A I don't know whether there was intent there to manipulate or not.

Q Well, in assessing intent, sir, would you look for legitimate reasons to do the transactions?

A I think in my own mind I found the reason for the transactions, okay, in my opinion. Whether it is legitimate or not, I'm not going to pass on that one.

The reason for the execution of the large block transactions (whether on the floor of the ASE or not) to which Callaghan referred was to show a profit in the books or enhance the stock as an investment. The stock was carried at 30¢ a share in the books, but was trading at $1.30.

Under cross-examination by Mr. White, Callaghan noted that where a purchaser of a stock is being guaranteed a profit by the vendor or a third party, such simply does not happen without special arrangements. He continued:

Q And, of course, the rule that we've all talked about so much is designed to prevent special arrangements which could lead the public into concluding that stock has a price it shouldn't have, correct?

A That's right. [37840]

Callaghan acknowledged that a stock's price is a function of supply and demand, which meant volume and price, and that those who are interested in stock consider both the price and the volume. Nevertheless, in the case of the block trades, Callaghan was not prepared to concede that if he were an investor, the block trades would influence him. He said he would be curious as to why the block trade had occurred. [37838-43]

CONCLUSION

There is no doubt that Pearce commenced his trading on behalf of Allarco in order to provide liquidity to the market for Matrix shares. But by December, 1986 Allarco was purchasing the stock on up-ticks, thereby increasing the price, and continued its purchasing activity for long periods of time in the absence of other buyers. Allarco often was the sole source of demand for the stock.

A review of Appendix A of Exhibit 596 shows that for substantial numbers of days there were no buyers but Allarco. As a general rule, during such times, Allarco seemed prepared to maintain a certain price even if one or two buyers purchased the stock at a higher amount. There are also instances where buyers had bought below Allarco's last trade, which had no effect on Allarco's trading activity. In other instances, buyers bought at an amount slightly higher than Allarco's last trade, and that price was then maintained by Allarco. There are instances where Allarco maintained a particular price, another buyer would then purchase at that price, Allarco would drop its price and then increase the price again. What is clear from Appendix A to Exhibit 596 is that Allarco had a very definite idea as to what the price ought to be, and it maintained that price, day after day, even in the absence of any other buyer. Pearce said that he was providing liquidity and order to the market. But he also admitted that what he did had the effect of maintaining the price where many shares were placed on the market.

I find that if Allarco and PGL had not participated in the market, the shares would not have traded consistently at the prices they did in December, 1986 through July, 1987. I recognize the evidence of Donald Cormie and Callaghan that certain events were occurring in Matrix which could have moved the stock price. However, as Appendix A to Exhibit 596 tends to show, there was seldom any demand for the stock at these prices except on the part of Allarco and PGL. It is clear from the evidence that there were few buyers at such prices; indeed, Watt testified that at $1.30 the stock was "expensive".

Donald Cormie had a great interest in Matrix shares. He conceived the stock bonus plans, and the large block trades (see Transactions #10, #16 and #17, *supra* for a discussion of the evidence concerning the purpose of these trades). The purpose of the plan conceived by Donald Cormie, the evidence tends to show, was to create value, both by creating market activity through employee stock plans and by initiating several large block trades through the market over a 6 month period. The creation of such value was necessary, for as noted elsewhere Matrix shares were used as currency within the Principal Group and had even been converted to loans in Transaction #10. Having been transferred at prices of $1.30 or more with consequent large accounting gains, it was important that the shares stay at such prices at least until completion of the 1986 audit.

The evidence also tends to show that Allarco was a component of the plan to create day to day market activity for Matrix shares where there would not otherwise be such activity at such prices. This was carried out by Pearce. Stefanski also made some trades during December, 1986 and January, 1987; however, I find she was not aware of the purpose of Allarco's activity, and that she was acting on the instructions of Pearce to make purchases during his absence. The second component was the PGL activity. While PGL owned millions of Matrix shares, it purchased the shares it required to fund the employee bonus plans on the ASE.

I find on the balance of probabilities that James Cormie was aware of Allarco's trading activity through December, 1986 when he conducted the large block trades on December 22, 24 and 30, 1986. I do not believe James Cormie's evidence [at 14458] that he instructed Pearce not to trade through Allarco on December 23 and 24, 1986 because Pearce was on holidays on those days. There is evidence from Warner showing James Cormie's involvement in Allarco's trading activity, and I do not find James Cormie's evidence concerning trading activity in Matrix shares to be credible. I do not find that James Cormie was responsible for and directed the trading activity in Matrix shares during Pearce's absence in parts of December, 1986 and January, 1987 on the ground that the only evidence tending to show it is hearsay.

The relevant activity of Donald Cormie is as follows: (a) authorizing and directing Allarco to apply its resources to the purchase of Matrix shares for the purpose of creating market activity in Matrix shares in circumstances where Matrix shares and, indirectly, Allarco itself (through FIC and AIC's holdings in AHL) were indirectly assets of FIC and AIC. In result one asset of FIC and AIC (Allarco's cash) was used to inflate another asset of FIC and AIC (Matrix shares) and to benefit employees of PGL; (b) directing that the large block transactions occur over the floor of a public market; and (c) creating a situation wherein the price of the Matrix stock could only be maintained through more and more purchases by Allarco and PGL.

The comments of the SEC in Release No. 34-2446, March 18, 1940, 11 F.R. 10967 are of interest:

> It should be further noted that stabilizing is regarded as necessary only in the case of issues which are neither notable successes nor notable failures. In the former case the market for the issue usually takes care of itself. In the latter, where the selling pressure in the open market is too great, the underwriters cannot afford to support the market at or near the issue's original offering price. For the same reason, stabilizing cannot as a practical matter be used to stem a market or economic trend of any real significance.

It also states:

> . . . The oft-repeated and, in our opinion, wholly justified complaint against security stabilizing is that when the operation is ended and the "peg is pulled", the market price of the security frequently drops with ensuing loss to all who purchased it on the basis of an artificial, "pegged" market price. Insofar as stabilization prevents falling market prices and thus permits the issuance of securities at unjustifiably high prices, the practice must be regarded as an evil. Similarly, the active trading which frequently results from the very fact of the distribution and the accompanying stabilizing at the offering price may also serve to invite other buyers into the market.

In this case, stabilizing worked because Allarco was directed to apply its cash to this activity. Ordinarily, market value on a stock exchange is considered to be the price established through such a large number of transactions as to standardize the price. Price will respond to the process of supply and demand. In the case of Matrix, the evidence tends to show, the demand was artificial. And, as in fact happened, when the "peg" was "pulled", the price dropped.

PGL owned millions of Matrix shares, and was buying more in the thin market — when it was not buying, Allarco was and did create the demand. Not one witness could explain why the purchases were made in the market by PGL. They were so made, the evidence tends to show, either for the purpose of creating, or at least foreseeing and hoping that the activity would be likely to create, additional demand for the shares with a consequent increase in their reported market value. Donald Cormie admitted it was important for Allarco to stay in the market with a bid and that also was intended to create demand and increase or maintain value. He also acknowledged that the effect of PGL's activity would be to support the price.

The large block trades (excepting that involving Hunter, Transaction #10) were made over the floor of the public market with the intent to represent that large blocks of Matrix shares were of market value equivalent to the prices at which the small trades were made when in fact, undisclosed, the buyers had no risk and no obligation to keep the shares. The representation was, the evidence tends to show, dishonest because (a) it was untrue; and (b) it was intended to be such a representation and not simply a side-effect of some legitimate business transaction. The trades further created at least a risk of prejudice to the economic interests of users of the market, who ought not to have been interfered with by Principal Group's activity aimed at impressing them and others (e.g., auditors, government regulators) with some unreal value for Matrix shares.

The purpose of this activity as a whole was to create gains through the transfer of Matrix shares. However, no one would realistically believe that large blocks of these shares were worth the values attributed to them. In the draft financial statements for the year ended December 31, 1986 for FIC, PGL (consolidated) and AHL, per share values ranging from $1.20 to $1.60 were attributed to Matrix shares on blocks ranging in size from 1,276,772 to 6,154,000 shares. They were simply recorded at the market value on the ASE at the time of the transaction. The evidence tends to show that this was fantasy. These prices could only be supported through guaranteed return, no-risk transactions or intercorporate transactions. The transactions were traded over the floor of the ASE to provide evidence to the auditors and others that large blocks of the stock could indeed trade at such prices without interference from regulators. The day to day trading activity was launched through the stock bonus plans to assist the effort. In doing so, the evidence tends to show, false market values were generated. Legitimate users of the ASE may well have been injured.

The evidence tends to show that Donald Cormie's conduct was dishonest in setting all the elements of this scheme in motion for the purpose of booking profits and in so doing interfering with or creating a risk of interference in a legitimate market. James Cormie participated with him in this activity.

The evidence tends to show that Pearce's activity degenerated over time as he caused Allarco to become more and more the only buyer of Matrix stock. His conduct was, however, legitimate, from the perspective of my mandate, because the evidence before me tends to show that he had no dishonest intent when he carried out the day to day trades. I am not satisfied that Pearce intended to create a fictitious premium on the stock although in fact such a premium was created.

Similarly, whether or not Levesque properly carried out its obligation in relation to Transactions #16 and #17 is not a question for me. Watt did not inquire into why PGL wished to enter into the large block transactions once he had learned that the transaction was for "internal reasons" and could not know PGL's purpose.

F. COLLATERAL LOANS

As noted elsewhere, part of management's response to the financial difficulties facing FIC and AIC was to put them into the business of making what were called "collateral loans" on the security of Principal mutual funds. The loans were reasonably profitable. However, the collateral loans also carried an element of intercorporate dealing and thus it is appropriate to mention them here.

Section 52 of the *CBICA* provides as follows:

> 52 The company shall not knowingly make an investment, other than a loan on the security of a policy of life insurance issued by it,
>
> (a) by way of a loan to
>
> (i) director or an officer of the company, or a spouse or child of that director or officer, or
>
> (ii) an individual, his spouse or any of his children under twenty-one years of age if either the individual or a group consisting of the individual, his spouse and the children is a substantial shareholder of the company;
>
> (b) in a corporation that is a substantial shareholder of the company; or
>
> (c) in a corporation in which
>
> (i) individual mentioned in subparagraph (a)(i),
>
> (ii) an individual who is a substantial shareholder of the company,

(iii) any corporation that is a substantial shareholder of the company, or

(iv) a group consisting exclusively of individuals mentioned in subparagraph (a)(i),

has a significant interest.

(2) The company shall not knowingly hold an investment that, at the time it was made, was an investment described in subsection (1).

(3) Notwithstanding subsection 51(3), a company is not prohibited from making an investment in a corporation only because a person or a group of persons that owns beneficially, directly or indirectly, or is deemed to own beneficially, equity shares of the company is by reason thereof deemed to own beneficially equity shares of the corporation.

In a legal opinion dated May 20, 1983 [Exhibit 484 at 91], P.M. Owen, Q.C. stated that if the borrowers were not officers, directors or substantial shareholders of or persons having a significant interest in FIC, AIC, Principal Group or the mutual fund companies, then the prohibition against investment, by way of loan or otherwise, to related parties in s. 52 (then s.33) of the *CBICA* would not apply. He also noted that it was clear that a direct investment in Principal mutual fund companies by FIC or AIC through the purchase of Principal mutual fund shares would be prohibited. Finally, he expressed the opinion that FIC and AIC could lend money on the sole security of mutual fund shares if it became a stated and immutable policy of the investment contract companies to dispose of any forfeited mutual fund company shares forthwith after acquiring same from a defaulting borrower.

James Cormie said he would have seen the Owen opinion at the time [13895], and Donald Cormie said that he would have reviewed it at some point, prior to voting on the PGL resolution of January, 1984 authorizing it to lend, which he signed. That resolution is referred to immediately below. [Exhibit 445; 17141-4]

By directors' resolution dated January 25, 1984 [Exhibit 445] FIC resolved to lend monies on the terms and conditions contained in the Principal Automatic Loan Agreement. AIC and PGL passed similar resolutions on the same day. [Exhibit 445]

PGL was able to borrow from FIC and AIC on terms more favourable than other mutual fund customers. While other customers of Principal Group (i.e., the public) could margin the funds up to 50% (that is, for every dollar of mutual funds purchased, the customer had to put up 50¢), PGL could borrow on a 95% margin (that is, for every dollar of mutual fund it only had to put up a nickel). Marlin authorized this preferential treatment on December 15, 1984.

It was on December 17, 1984 that PGL resolved to enter into a Principal Automatic Loan Agreement and Loan Advance and Disclosure Form with respect to 3 mutual fund accounts, and to borrow against these accounts in such amounts as the directors deemed advisable from time to time. Donald Cormie testified [17161-4] that the purpose of the resolution was to bring PGL onto the standard margin system in the event it bought mutual funds. PGL immediately borrowed $3,500,000 from FIC and $500,000 from AIC. This was the same day as PGL injected $5,000,000 of "capital" into FIC and as noted in the discussion concerning Transaction #1, I find it difficult to believe this was coincidence. [Exhibit 446; Exhibit 563 at 466, 469, and 471, Exhibit 451 at 35; 13351-2; 17251-2; 21141-3; 22052-60]

Substantial amounts of these mutual fund loans were due to FIC and AIC from affiliated companies, PGL and PSML. Wooldridge reported [Exhibit 545 at 294] that as at December 31, 1986, FIC had recorded $7,991,000 of collateral loans due from PGL. AIC recorded $17,589,000 of collateral loans due from PGL, and $6,260,000 due from PSML. The AIC annual examinations [Exhibit 551] prepared by government auditors reported that collateral loans to PGL by AIC, totalling $502,853 at December 31, 1984, were deemed to be prohibited investments under s. 52 of the *CBICA*. For the year ended December 31, 1985 the amount was $725,000. Comparable figures for FIC were $3,153,000 on December 31, 1985 and $3,500,000 on December 31, 1984. [Exhibit 550 at 290 and 364]

Lending money to PGL by FIC and AIC would be a prohibited investment according to Owen's opinion. That was the only opinion the companies had on the subject.

On a related matter, Donald Cormie was asked in relation to Transaction #3 why, since he had seen the Owen opinion, it did not occur to him that investment in AHL would be the subject of the same prohibition. He said Principal Group had the opinion of Parlee of June, 1984 that AHL shares were qualified assets. That opinion did not deal with s. 52 of the *CBICA*, the applicability of which was not raised with that law firm until 13 months later. Donald Cormie said he did not remember going through the response (to the effect that s. 52 of the *CBICA* was not applicable to FIC and AIC) in detail, but it was his impression from meetings with the regulators years earlier that Investors Syndicate (another investment contract company) had stressed the fact that s. 34 of the *ICA* referred to permissible investments within the *CBICA*, but did not pick up the prohibition contained in s. 52 of the *CBICA*. [17339-45]

Under cross-examination by Mr. White on a slightly different topic [21982-3], Donald Cormie said in response to a question whether in his own mind FIC and AIC were entitled to buy mutual funds for their own account, that he would see no reason why they could not. Later in the hearings Donald Cormie gave the following testimony:

> Q Certainly, sir, there is nothing at that time [1984], as you have already told us, to prohibit the contract companies from buying mutual funds in their own accounts?
>
> A I don't know that. I didn't examine that question at that stage. I don't know.
>
> Q Well you told us earlier that there wasn't.
>
> A My understanding was there was no inhibition, yes. [22054]

Donald Cormie's evidence is contradictory, but I find he was aware of legal opinions stating that FIC and AIC could not lend money to affiliates. [17339-45] He was also aware of opinions from which one might conclude such activity was permissible. Whether he believed such activity was legal or not, the point is that Donald Cormie and his fellow PGL directors took no objection to intercorporate dealings.

As a result, when FIC and AIC needed more and more investments to support their increasingly non-earning asset portfolio, and PGL needed more and more mutual fund investments to attempt to prop up its asset portfolio to support the promissory notes issued to the public, resort was again had to intercorporate dealings. The objective, standing alone, is laudable since both FIC and PGL were seeking profitable investments on the rising mutual fund market. But the intercorporate dealings could be carried out on far more favourable terms, at least for PGL. There may be some reason for the higher margin. Principal Group could obviously better monitor and control the margin levels and creditworthiness of the affiliated borrowers. On the other hand, FIC might not enforce its rights against PGL as vigilantly as it would in the case of an unrelated customer. In any case, as these loan balances escalated, the fortunes of FIC and AIC became tied to a single investment (i.e., stocks and bonds). If these markets dropped, the collateral security, margined at 95%, would not cover the loan balances and owing to PGL's insolvency, PGL's covenant to pay was unlikely to make good the shortfall. Marlin and Donald Cormie, the evidence tends to show, in this context again unfairly disregarded the interests of the security holders of FIC and AIC. With the advantages of interlocking corporate structure come also the responsibilities. Therefore, one might expect FIC to feel pressure to lend to PGL on the standard margin system and the legal position might not have been clear at the time. However, PGL in its duty of scrupulous fairness, the evidence tends to show, ought not to have been borrowing from FIC and FIC ought not to have been lending. The reason was simple. The borrower was insolvent.

I must also report that there is no evidence that FIC and AIC suffered loss from this activity.

G. ACCOUNTING POLICIES AND PRACTICES OF THE COMPANIES

1. INTRODUCTION

For some years prior to the fiscal year ended 1982, Deloitte Haskins & Sells were the external auditors of Principal Group. The Group received proposals from various accounting firms and retained new auditors for the year ended 1982, Touche Ross & Co. That firm completed the audit of the financial statements for the years ended 1982 and 1983. In August, 1984 management changed auditors and Deloitte Haskins & Sells again became the auditors.

The accounting policies and practices within the Principal Group of Companies were designed to recognize income as soon as possible and to defer losses for as long as possible. The auditors of the Principal Group of Companies for the year ended 1983 had written in a letter to Donald Cormie dated July 16, 1984 that they:

> . . . believe there should be a greater element of conservatism put into your accounting practices. Too often, in the past, the accounting policies have been oriented towards recognizing profits early and deferring expenses to later periods. This, we believe, has had a detrimental impact on management decisions and has contributed to creating a false sense of security, and lack of financial realism. [Exhibit 447 at 162]

What follows details many financial practices implemented after 1983 in furtherance of what the evidence tends to show was a strategy to defer the recognition of insolvency for as long as possible. Since Principal Group had no recent accounting or policy manuals, much reference will be made to the evidence of the Group's auditors to define the policies. It will be necessary to detail the valuation of mortgages and owned property for the years ended 1982 and 1983 in order to illustrate some of the changes which occurred in 1984.

2. MORTGAGE VALUATION IN 1982 AND 1983

Conventionally, broadly speaking, mortgages are carried by mortgagees on their books at their cost less allowances or provisions for losses. The assessment of losses on mortgages is based on the collectibility of the loan having regard to all available sources for repayment, including the borrower's covenant to pay, the value of the underlying security, and the availability and value of any collateral security including guarantees. It is clear from the evidence (which is reviewed in the section on investment strategies) that Principal Group, in its lending, emphasized the equity of the real property security rather than the strength of the borrower's covenants. As a result, valuation of the underlying security became a critical issue in determining whether allowances for losses should be made.

For the fiscal years ended December 31, 1982 and 1983, the disclosed accounting policy relating to mortgage loans for both FIC and AIC in the notes to the audited financial statements was as follows:

> Mortgages are recorded at amortized cost, which includes amounts advanced, interest capitalized and accrued, less repayments, prepaid property taxes, unamortized mortgage discounts and allowance for anticipated losses. Mortgage discounts are amortized over the term of the applicable mortgages. [Exhibits 272 and 273]

That was a change from the disclosure made in the financial statements for the fiscal year ended December 31, 1981, noting that mortgages were recorded net of an allowance for losses. Pennock, an audit partner of Touche Ross & Co., testified that prior to the audit for the year ended 1982, management of Principal Group had not established provisions for losses on mortgages for the fiscal year ended December 31, 1982. [23797]

Management's starting position in the years 1982 and 1983, according to Pennock, was that there was no need for any provision for losses on mortgage loans, owing to Donald Cormie's clearly stated position in 1982 and even through 1983 that he had never lost money on a mortgage and he had no intention of losing money on a mortgage. Accordingly, the process undertaken by the auditors was one of negotiation, pulling together evidence to refute that position. Ultimately, management agreed to book a provision for loss against the mortgages. For the year ended 1982, the provisions booked were $800,000 for FIC, $250,000 for AIC and $150,000 for PS&T. [Exhibit 526 at 55; 23802]

Pennock testified that the actual negotiations and decision making around losses occurred with Petracca, and ultimately, Donald Cormie. [23815-6]

The auditor's approach to valuing the mortgage portfolio was a matter of judgment. During his evidence, Pennock adopted the following extract from the Honourable W.Z. Estey, *Report of the Inquiry into the Collapse of the Canadian Commercial Bank and Northland Bank*, at 619:

> The valuation of security underlying a loan is a highly subjective, judgmental process. The auditors should look for evidence that the valuation assumes a reasonable time frame for disposition and is based on assumptions that are reasonable, perhaps tending a little to the conservative side. Appraisals are an important element in the evaluation of security, but they are not the final word or the only element. It is not the standard practice for an auditor to obtain an independent appraisal. [23807]

Pennock testified that valuation of the security underlying mortgage loans was primarily appraisal based. However, coming into the 1983 year end, Pennock was of the opinion that there was not a market for real estate or that there was an "awfully thin market", considering that the best indicator of market value of real estate was comparable sales. His evidence was that through 1982 and to the end of 1983, trades were thin, and the trades that were occurring through that period were barter deals and forced sales. There was not a firm market on larger pieces of real estate. Pennock testified that as a result there was a good deal of uncertainty within the real estate market and that the industry generally was having difficulty in establishing values and determining where the market was moving.

Accordingly, the underlying principle upon which Touche Ross & Co. based its judgment was that assets were to be carried at values not exceeding the enterprise's ability to realize upon them, either through sale or through use and operations. If it was determinable that there was a loss or likely loss on a mortgage, the mortgage was written down, having regard to the underlying security, payment history of the mortgage loan, any "current activity" on the loan, the most recent appraisals, and other circumstances relating to each mortgage. Such a writedown reduces the carrying value of the mortgage loan and is recorded as an expense on the income statement. It was also proposed to management that there should be identified separately the potential or possible loss if real estate markets did not return to more "normal levels". This category would be disclosed as a contingency but would not affect the reported value of the assets, nor the income. A third category was proposed where there were exposures to loss, but not of sufficient significance to warrant booking a provision for loss (the first category) or identifying a possible loss (the second category). [23806-13]

In addition to assessing exposures and losses on specific mortgages, a general provision for losses and a general exposure to further losses were established. The amounts established for the general figures were based on a pro-ration of the balance of delinquent mortgages which had not been reviewed in detail. [23814]

It should also be noted that based upon knowledge gained through the 1982 audit and interim reviews conducted in April and September, 1983, Touche Ross & Co. prepared listings of particular mortgage loans and had Principal Group obtain appraisals of their underlying real estate security. [23816]

In a letter dated July 18, 1984 from Pennock to the Superintendent of Insurance [Exhibit 526 at 181], the method of valuation with respect to mortgage loans was described as follows:

> Management's approach to the valuation of the companies' mortgage and real estate portfolio was to firstly provide for all losses where a permanent decline in value is thought to have occured, [sic] and secondly, to give an indication to the reader of the financial

> statements of the considered additional exposure if real estate markets do not return to normal and stable levels.

Pennock testified that the letter should have properly referred only to mortgages. [23891-2; 24034]

It appears that the reference to "normal and stable levels" refers to a separate level in the case of each mortgage which had been assessed. Where there was a decline in value on any given mortgage from the time of lending until the time of the audit, the loss was booked where it was permanent, and where temporary, an exposure was noted. [23882-99]

In assessing the mortgage portfolio, Touche Ross & Co. had regard to s. 3050 of the Canadian Institute of Chartered Accountants Handbook which is applicable to longterm investments: [Exhibit 528 at 46]

> LOSS IN VALUE OF AN INVESTMENT
>
> .29 A loss in value of an investment that is other than a temporary decline will sometimes occur; that is, the actual value of the investment to the investor may become lower than the carrying value and the impairment is expected to remain for a prolonged period.
>
> .30 A decline in market value may be only temporary in nature or may reflect conditions that are more persistent. Declines may be attributable to general market conditions that reflect prospects of the economy as a whole or prospects of a particular industry. Such declines may or may not indicate the likelihood of ultimate recovery of the carrying amount of an investment. A decline in quoted market value below carrying value of an investment with a fixed maturity amount may be considered temporary unless it is anticipated that the investment will be disposed of before it matures or that the carrying value may not be realizable.
>
> .31 A loss in value of an investment that is other than a temporary decline is obvious in some cases, such as bankruptcy or an agreement to sell an investment at an amount which will result in a loss. In less obvious situations, impairment of the value of an investment may be indicated by conditions such as:
>
> (a) a prolonged period during which the quoted market value of the investment is less than its carrying value;
>
> (b) severe losses by the investee in the current year or current and prior years;
>
> (c) continued losses by the investee for a period of years;
>
> (d) suspension of trading in the securities;
>
> (e) liquidity or going concern problems of the investee;
>
> (f) the current fair value of the investment (an appraisal) is less than its carrying value.
>
> However, when a condition, indicating that an impairment in value of an investment may have occurred, has persisted for a period of three or four years, there is a general presumption that there has been a loss in value which is other than a temporary decline. This presumption can be rebutted by persuasive evidence to the contrary.
>
> .32 When an investment is consolidated, a decline in value that is other than temporary would be reflected by a reduction in the carrying values of specific tangible and intangible assets to the extent that such assets have declined in value. When either the equity method or the cost method is used, a decline in value that is other than temporary would be recognized by writing down the investment.
>
> .33 When there has been a loss in value of an investment that is other than a temporary decline, the investment should be written down to recognize the loss. The write-down would be included in the determination of income and may or may not be an extraordinary item . . .

Pennock testified that because the lender does not have title to the secured property, and cannot sell such property even if it wanted to until such time as foreclosure action was completed, the mortgage loan is a long term investment within the meaning of the Handbook. [23891] Therefore, the mortgage loan need not be written down if the decline in value of the security was not permanent. Pennock testified that the level from which the mortgages had declined was determined on a mortgage-by-mortgage basis. He also testified that Touche Ross & Co. had not established a time frame within which real estate markets would return to more stable and normal levels, but were stating that the real estate markets were uncertain. [23884; 24022-4; 24148; 24171-2]

The application of this methodology resulted in distinctions disclosed on the financial statements between estimated exposures and losses. In the case of FIC for the fiscal year ended December 31, 1983 there was an estimated exposure of $10,000,000 if the current market levels represented a permanent decline, and a presently recognized loss of $1,990,000; for AIC, an estimated exposure of $2,950,000 and a presently recognized loss of $653,000; and for PS&T, an estimated exposure of $1,635,000 and a presently recognized loss of $233,000 (this excludes the mortgage and owned property interests transferred to FIC in relation to Transaction #1). In addition to its $10,000,000 exposure and $1,990,000 loss, FIC incurred an estimated exposure of $3,500,000, and a loss of $1,050,000 owing to Transaction #1. [Exhibit 526 at 56-7] These figures include both the specific exposures and losses and the general exposure and loss figure. [23814]

The estimated exposure was disclosed in the notes to the 1983 audited financial statements. In the case of FIC and AIC, Note #1 provided, in part:

> These financial statements have been prepared in accordance with accounting principles generally accepted in Canada and have been presented on a going concern basis, which should be considered in relation to Note 9, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. [Exhibits 272 at 43 and 273 at 45]

Note #9 provided:

> 9. Contingencies
>
> It is the policy of the Company to provide an allowance against income to meet future general and exceptional losses arising from the Company's mortgage and owned property portfolio. The cumulative allowance for anticipated losses which has been provided for in the accounts is [AIC: $953,000; FIC: $2,890,000]. The amount of the allowance is a discretionary matter, as judged necessary by its directors and management, based on their knowledge of the Company's affairs and their assessment of the economic conditions of the provinces (mainly Alberta and British Columbia) where the current security for the mortgages is located. Because of the complexities of the real estate market, and the economic uncertainty surrounding the underlying values, and the present undeterminable value of collateral securities to the mortgages, an estimated additional exposure of [AIC: $2,950,000; FIC: $10,000,000] exists if current market levels represent a permanent, rather than a temporary, decline in value. [Exhibits 272 at 48 and 273 at 49]

Note #9 continued in the case of FIC only:

> In addition to the exposure relating to mortgages and owned property on hand at December 31, 1983, the Company has increased its exposure by $4,600,000 relating to interests redeemed in mortgages and owned property, subsequent to the year end as outlined in Note 8(a). [Exhibit 272 at 48]

PGL's audited consolidated financial statements for the year ended 1983 also contained a contingency note. [Exhibit 274 at 41] It provided, in part:

> 10. Contingencies
>
> (a) Three subsidiary companies that have been consolidated into these financial statements invest in mortgages and secured loans as part of their business. It is the policy to provide an allowance against income to meet known and anticipated losses arising on the mortgages and owned property portfolios. The cumulative allowance for anticipated losses which has been provided for in the accounts is $5,326,000. Because of the complexities of the real estate market and the economic uncertainty surrounding the underlying value of real estate in Alberta and British Columbia and the present undetermined values of additional collateral securities and guarantees to the mortgages, these companies in total have an additional exposure to loss of $18,200,000 if the current market levels represent a permanent rather than a temporary decline in value.

These audited consolidated financial statements (which were not completed until early 1985) also contained a warning in Note #1 that was in substance identical to the above quoted portion of Note #1 to the FIC and AIC audited financial statements. It is noted that the shareholder's equity of PGL for the year ended 1983 was $10,568,000 — less than the amount of the contingency.

Pennock testified that the concept of these notes was to disclose to the reader of the financial statements that although the losses were not such that they ought to be booked, there was a contingency involved — namely, an exposure to loss that fell short of justifying a write down — of which the reader ought to be aware. [23821] The notes were meant to bring "the reader's attention to the possibility that the enterprise may be unable to continue realizing its assets and discharging its liabilities in the normal course of business". [Exhibit 528 at 102]

It is notable that for the year ended 1983, realization of the contingency would have eliminated the capital of FIC, AIC and PGL. Donald Cormie, as reported hereafter, was not in favour of the notes. Moreover, as mentioned below in the part of this Chapter on Transaction #2, PGL acquired an additional $12,500,000 in new capital in 1984 in an undisclosed related party transaction and funded the purchase of that capital.

While much was made in the evidence of whether or not the above quoted notes to the financial statements were "going concern notes", no witness expressed any lack of understanding as to what the notes meant or opined that they failed to convey a cause for concern: for example, Schenkelberg [36032-3]; Davidge [37583-8]. It was the opinion of Richard Cormier, an audit partner of Clarkson Gordon who gave opinion evidence:

> In 1983, it is possible that additional losses could have been provided for rather than disclosed as a contingency. However, the uncertainties in the real estate market were only just becoming apparent in that year, appraisals were generally unreliable and we believe there was general uncertainty regarding real estate values. Given this environment we believe that the disclosures used and levels of provisions were appropriate. [Exhibit 600 at 15-16]

3. OWNED PROPERTY VALUATION IN 1982 AND 1983

The following is a detailed review of the evidence on owned property valuation for the fiscal years 1982 and 1983. There is clear evidence of a dramatic change in owned property valuation for the fiscal year ended December 31, 1984.

For the fiscal year ended 1982, the audited financial statements of FIC and AIC [Exhibits 272 at 68 and 273 at 56] disclosed that:

> Real estate obtained in satisfaction of debts are [sic] valued at the lower of cost or market value.

For the fiscal year ended 1983, the disclosure was:

> Owned property *as a group* is valued at the lower of cost and market value. [Emphasis added.] [Exhibits 272 at 55 and 273 at 45]

The corresponding note in the audited consolidated financial statements for PGL referred to the lower of cost and "net relizable value" in 1983, and to the lower of cost and "market value" in 1982. [Exhibit 274 at 36, 51]

Pennock testified that no individual owned property required a specific write down in 1982. [24317] The analysis of all owned property collectively as a pool (as opposed to parcel by parcel) was contemplated, but never used, in 1982 because there was no write down of any of the individual properties. [24317-8] Pennock testified that write downs were not required in 1982 because, on review, Touche Ross & Co. were satisfied that in aggregate, real estate was recorded at the lower of cost and market. [23803]

For the year ended 1983, owned properties were valued as a group. The effect of this accounting policy was that unrealized gains within the real estate portfolio could be offset against recognized losses.

The working papers of Touche Ross & Co. [Exhibit 526 at 56-57] disclose that as at December 31, 1983, the losses to be booked in relation to owned property were: FIC, $900,000; AIC, $300,000; and PS&T, $200,000. No estimated exposure is shown for any owned property and Pennock testified that the reason was that the accounting policies for the valuation of owned properties were different than those applicable to mortgage loans. [23827] As will be noted below, real estate was considered to be inventory and was carried at market value.

Pennock testified that market value, for the most part, was considered to be appraised value and that the approach to putting a value on real estate was appraisal based. He testified that appraisals dated prior to late 1982 were not considered. Since most of the real estate had been foreclosed in the period subsequent to June, 1982 and most of it in 1983, foreclosure appraisals were available. Pennock testified that in the case of real estate the lender's only recourse was to sell each property, and that these lenders, FIC, AIC and PS&T were in the process of getting the properties ready for sale. He understood that Principal Group's strategy was not to hold the owned properties over the long term. Real estate, being something listed for sale, was not considered a long term investment within the CICA handbook but rather as inventory. Therefore, the accounting principle as applied to mortgage loans that only losses in value that are "other than temporary" are written down, was not applicable to owned property. Real estate was instead carried at market value regardless of whether the loss in value was temporary or permanent. [24151-7; 23795-7; 23807; 23889-92; 24000-1; 24021]

It is apparent from the working papers [Exhibit 526 at 85-90] that the approach utilized was to compute the difference between the aggregate of the balance of each owned property account as at December 31, 1983 and the aggregate of the foreclosure appraisal values. The working paper, which was prepared by Principal Group and not Touche Ross & Co. expressly states that the values used were "Foreclosure Appraisal — Market Value".

There was some suggestion made during the course of the hearings that, in fact, Touche Ross & Co. had evaluated the owned property on the basis of some long term value. For example, in the previously mentioned July 18, 1984 letter authored by Pennock, the Principal Group's approach to mortgage valuation and real estate valuation had not been differentiated. Pennock testified that in fact they were. [23891-2; 24034; 24082]

Similarly, Note 9 to the financial statements of FIC and AIC did not differentiate between mortgages and owned property although I note that the description of the contingency itself is made applicable only to the "collateral securities to the mortgages" and not to the owned properties.

It was suggested that these auditors also made certain representations during meetings with government regulators which were not consistent with what they said they did. The "Red Book" (*infra*) was presented at a meeting on October 2, 1984. Notes of that meeting were kept by Bokhari, a government regulator. [Exhibit 526 at 230-237] The minutes of the meeting appear to relate primarily to mortgage valuation and in fact, no discussion is recorded in relation to that section of the Red Book dealing with owned property. In relation to mortgage valuation, the minutes record that Bercov asked Ashcroft (from Touche Ross & Co.) to describe the criteria used in determining whether a mortgage ought to have a loss provided or no loss provided at all. Ashcroft is recorded as having replied that if in "our judgment, the property will return to 1980/81 value, no loss is anticipated."

Pennock (who was also present at the meeting and was the audit partner who reviewed and participated in the audit of mortgages and owned property) testified that he did not believe that Ashcroft would make such a statement because 1980 and 1981 were not a "bench mark" for the auditors. [23910]

Bokhari testified that the dispute under discussion at the meeting was whether the decline in value had been permanent or temporary. He applied this concept to both owned property and mortgages. [27886-90] The question arose as to the time period from which the decline had occurred. Bokhari's evidence on that point was as follows. He testified that the reference point was 1981-82. [27889] In cross-examination, he testified that the decline under discussion was the one which had occurred from December 31, 1982 until December 31, 1983. [27906]

During his testimony, Pennock gave evidence regarding one such mortgage where a permanent decline as of December 31, 1982 had been identified; an additional exposure for further decline had been identified in the year 1983. I accept that, in evaluating real property security underlying mortgage loans, these auditors were not necessarily anticipating a return to 1980 or 1981 values, but rather were assessing declines in value and where declines were identified, whether such declines were permanent.

Discussion also centered around the document placed in evidence known as the "Red Book". [Exhibit 526 at 188-229] Pennock testified that the Red Book was prepared by Principal Group with the assistance of Touche Ross & Co. and was a response to requests made of Principal Group by the Alberta regulators for information. The Red Book states: [Exhibit 526 at 190]

> Management assessed the value of its owned property as a group by estimating the long term market value of each property in the portfolio. The estimated long-term market value of the entire portfolio was then compared to the aggregate book value of the portfolio and an adjustment made to reduce the book value to estimated long-term market. This adjustment was charged to income.
>
> Liquidation values were not considered an appropriate measure of valuation for the port folio. Liquidation values would only be appropriate to these companies if they were forced to liquidate the assets in other than an orderly fashion over time. The Act even provides the companies with a seven year period to dispose of real estate.

The Red Book stated in relation to mortgages: [Exhibit 526 at 190]

> Mortgages are valued at amortized cost, which includes amounts advanced, interest capitalized and accrued, taxes and other charges, less repayments, unamortized mortgage discounts and allowance for anticipated losses.
>
> In assessing the portfolio, management provided for all known and anticipated losses with a charge to income where it was estimated that on a long term basis, there had been a permanent decline in value of the underlying security. Known losses are relatively clear. Anticipated losses are more a matter of conjecture. However, when management anticipated a permanent decline had occurred in the value of the underlying security, a loss was recognized. Where applicable, any secondary collateral security including the worthiness of guarantees was reviewed, evaluated and incorporated in assessing overall value at year end. Where

> management estimated that the value of the property together with the value of the secondary security was insufficient to cover the balance outstanding, it was written down to the estimated long term value.
>
> Where management determined there was a temporary decline in value, that in the long term it was reasonable to assume would recover, the reader of the financial statements was made aware that there was additional exposure of risk of loss if a recovery in value did not occur. The exposure in these instances was measured by the difference between the estimated value that could be realized on a short term basis and the estimated long term value.
>
> Liquidation values of underlying securities were not considered an appropriate measure of valuation for the portfolio. Liquidation values would only be appropriate to these companies if they were forced to liquidate the assets in other than an orderly fashion over time.

Similarly, in part two of the Red Book, it is stated that the objective in the case of valuation of mortgages was to determine a reasonable valuation and, where necessary, a provision for loss and any exposure should the current economic condition of the Alberta and British Columbia real estate markets represent a more permanent decline in value. In contrast, the section relating to owned property states that a property-by-property assessment of book values and estimated market value was assembled by the manager of the mortgage department and where deemed appropriate, foreclosure appraisals were used as a basis for establishing values.

Thus, the Red Book recognized different approaches to the valuation of owned property and the valuation of underlying security for mortgage loans.

Accordingly I accept Pennock's evidence that, for the most part, owned property was valued in 1983, as a group, at the lower of cost and market value. I accept his evidence that the portfolio valuation was "primarily" appraisal based. I also conclude that in some instances longer term values were used, probably where foreclosure appraisals were out dated.

It is worth noting that had owned property been valued for the year ended 1983 on an item-by-item basis rather than collectively as a pool, there would have been an additional write down of $3,231,000 across the entire portfolio (AIC, FIC and PS&T). [Exhibit 531 at 4]

Cormier summarized the 1983 valuation approach to owned property as follows:

> . . . As most property included in the foreclosed property balance on the balance sheet was acquired in 1983, the appraisals used for valuation purposes would have been relatively current. [Exhibit 600 at 24]

Owned property held by PGL on a consolidated basis increased during 1983 by approximately $26,000,000 [Exhibit 526 at 84], representing approximately 67% of owned property held as of December 31, 1983. As noted earlier, Pennock testified that most of the owned property came onto the books subsequent to June, 1982. To the extent the valuation was not appraisal based, it is worthy of note that the values were assembled by the officers of the Mortgage Department of PGL. These officers were, as noted below, more conservative in their valuations than members of senior management.

4. VALUATION OF MORTGAGES AND OWNED PROPERTIES IN 1984 AND 1985

Cormier gave evidence that "market value" can be equated with "net realizable value", neither of which are necessarily the same as "current market value". [34335] However, he testified that the determination of value is an attempt to determine the present value, based on factors which may occur in the future, which is not considered equivalent to determining what the value would be in the future. [34342] Similarly, Shaske testified that market value can be defined as being the present worth of probable future events. [36498; 36524] He also testified that during the recession, which was considered abnormal, the proper technique in capitalizing income in the case of valuing an income producing property would be to "normalize" it, which was premised on the basis that the relevant factor was going to return to some higher level. [36512-3]

Deloitte Haskins & Sells were re-engaged as auditors for the fiscal year ended 1984. The audit partner, McCutchen, testified that his firm was approached by Petracca, Donald Cormie and Marlin in August, 1984. He was told that the Principal Group and its subsidiaries were considering a change of auditors. He further testified that there was to be a change owing to a concern of the timeliness of the completion of the audits by Touche Ross & Co. In addition, McCutchen testified that these officers were concerned about the method and results of the valuation process in relation to the mortgage and owned property portfolios, and that there was disagreement between the individuals at the meeting and Touche Ross & Co. as to how to value those assets. He was given no further details. [24483-84] He further testified that the auditors' valuation had been lower than management's expectation. [24484] Pennock testified that Donald Cormie told him that "the long term relationship that he [Donald Cormie] had with Deloitte Haskins & Sells proved to be invaluable". [23972]

For the year ended 1984, the notes to the audited financial statements of FIC and AIC [Exhibits 272 at 33, and 273 at 32] provided, *inter alia*, as follows:

> **Loans**
>
> Mortgages are recorded at amortized cost, which includes amounts advanced, interest capitalized and accrued, taxes and other charges, less repayments, unamortized mortgage discounts and allowance for anticipated losses. Mortgage discounts are amortized over the term of the applicable mortgages.
>
> Collateral loans are recorded at cost, which includes amounts advanced and interest accrued, less repayments and allowance for anticipated losses.
>
> Where the loan principal and interest on mortgages and collateral loans exceeds the appraised value of underlying security, the company provides for losses if, in the opinion of management, the recovery of the loan amount and accrued interest is doubtful.
>
> **Owned Property**
>
> Land held for resale:
>
>> Land held for resale is recorded at the lower of cost and estimated net realizable value.
>
> Income producing properties:
>
>> Income producing properties are recorded at cost. Where, in the opinion of management, there has been a permanent decline in value, the carrying value of the asset is written down to reflect this permanent decline. The provision for depreciation is calculated so as to depreciate the assets over their estimated useful lives on the diminishing balance method.
>
> Land held for development:
>
>> Land held for development is recorded at cost. Where, in the opinion of management, there has been a permanent decline in value, the carrying value of the asset is written down to reflect this permanent decline. The company capitalizes direct carrying costs on properties where the appraised value is in excess of cost. These direct carrying costs, including [sic] interest, property taxes, legal fees and those general and administrative expenses that are clearly identifiable with specific projects.

Income producing properties were valued on a pool or group basis, although that is not disclosed in the note. [24535]

The PGL audited consolidated financial statements contain a similar note, except that the note defines owned property as representing property acquired by foreclosure. [Exhibit 274 at 20A-21]

Owned property was also divided into these same 3 groups in the financial statements for the fiscal year ended 1984.

The FIC audited financial statements for the fiscal year ended 1984 further disclosed: [Exhibit 272 at 35-7]

> ### 3. MORTGAGE LOANS
>
> The company has investments in commercial and residential mortgages, some of which are in arrears. Provisions have been made for possible losses on such mortgages where, in the opinion of management, losses may be suffered and the investment in mortgages is shown net of these provisions in the balance sheet. However, there are mortgages against which no provision has been made where the latest appraised value of the underlying security is less than the amount of principal and interest owing to the company. Whether or not the company will eventually realize its full investment is dependent upon several factors, the main factor being whether or not anticipated improvements in economic conditions materialize. During the year, $4,650,000 has been appropriated from retained earnings to a general mortgage reserve to cover this potential exposure (Note 8(b)).
>
> . . . . .
>
> ### 5. OWNED PROPERTY (continued)
>
> Income producing properties and land held for development have been written down, where necessary, to reflect any permanent decline in value. However, there are properties where no write down has been made where the latest appraised value is less than the book value. Whether or not there has been any permanent decline in the value of these properties is dependent upon several factors, the main factor being whether or not anticipated improvements in economic conditions materialize. During the year, $5,540,000 has been appropriated from retained earnings to an owned property reserve to cover this potential exposure where the decline in value is not considered to be permanent (Note 8(b)).
>
> . . . . .
>
> ### 8. RETAINED EARNINGS
>
> (a) Retained earnings as at December 31, 1984 is comprised as follows:

Deficit — unappropriated	$ (7,200,616)
General mortgage and owned property reserve (Note 8(b))	10,190,000
Retained earnings, December 31, 1984	$ 2,989,384

> Shareholders' equity as at December 31, 1984 amounted to $10,530,093. After appropriating $10,190,000 to a general mortgage and owned property reserve, surplus shareholders' equity of $340,093 existed as at that date. In addition, $11,800,000 in shareholders' subordinated notes was outstanding at December 31, 1984 (Note 6).
>
> (b) The general mortgage and owned property reserve is comprised as follows:

General mortgage reserve (Note 3)	$ 4,650,000
Owned property reserve (Note 5)	5,540,000
General mortgage and owned property reserve, December 31, 1984 (Note 8(a))	$10,190,000

> In future years, as economic conditions dictate, the general mortgage and owned property reserve will be adjusted to reflect managements' best estimates of the reserves required.

Realized gains and losses on the disposal of mortgages and owned property will be charged against income in the year in which they arise.

The notes for AIC stated: [Exhibit 273 at 34-6]

3. MORTGAGE LOANS

The company has investments in commercial and residential mortgages, some of which are in arrears. Provisions have been made for possible losses on such mortgages where, in the opinion of management, losses may be suffered and the investment in mortgages is shown net of these provisions in the balance sheet. However, there are mortgages against which no provision has been made where the latest appraised value of the underlying security is less than the amount of principal and interest owing to the company. Whether or not the company will eventually realize its full investment is dependent upon several factors, the main factor being whether or not anticipated improvements in economic conditions materialize. During the year, $1,325,000 has been appropriated from retained earnings to a general mortgage reserve to cover this potential exposure (Note 8(b)).

. . . . .

5. OWNED PROPERTY (continued)

Income producing properties and land held for development have been written down, where necessary, to reflect any permanent decline in value. However, there are properties where no write down has been made where the latest appraised value is less than the book value. Whether or not there has been any permanent decline in the value of these properties is dependent upon several factors, the main factor being whether or not anticipated improvements in economic conditions materialize. During the year, $920,000 has been appropriated from retained earnings to an owned property reserve to cover this potential exposure where the decline in value is not considered to be permanent (Note 8(b)).

. . . . .

8. DEFICIT

(a) Deficit as at December 31, 1984 is comprised as follows:

Deficit — unappropriated	$2,689,434
General mortgage and owned property reserve (Note 8(b))	2,245,000
Deficit, December 31, 1984	$ 444,434

Shareholders' equity as at December 31, 1984 amounted to $2,255,566. After appropriating $2,245,000 to a general mortgage and owned property reserve, surplus shareholders' equity of $10,566 existed as at that date.

(b) The general mortgage and owned property reserve is comprised as follows:

General mortgage reserve (Note 3)	$1,325,000
Owned property reserve (Note 5)	920,000
General mortgage and owned property reserve, December 31, 1984 (Note 8(a))	$2,245,000

In future years, as economic conditions dictate, the general mortgage and owned property reserve will be adjusted to reflect managements best estimates of the reserves required.

> Realized gains and losses on the disposal of mortgages and owned property will be charged against income in the year in which they arise.

The PGL consolidated audited financial statements disclosed: [Exhibit 274 at 23-5]

> 3. MORTGAGE LOANS
>
> The company has investments in commercial and residential mortgages, some of which are in arrears. Provisions have been made for possible losses on such mortgages where, in the opinion of management, losses may be suffered and the investment in mortgages is shown net of these provisions in the balance sheet. However, there are mortgages against which no provision has been made where the latest appraised value of the underlying security is less than the amount of principal and interest owing to the company. Whether or not the company will eventually realize its full investment is dependent upon several factors, the main factor being whether or not anticipated improvements in economic conditions materialize. During the year, $6,390,000 has been appropriated from retained earnings to a general mortgage reserve to cover this potential exposure (Note 10(b)).
>
> 4. OWNED PROPERTY
>
> Income producing properties and land held for development have been written down, where necessary, to reflect any permanent decline in value. However, there are properties where no write down has been made where the latest appraised value is less than the book value. Whether or not there has been any permanent decline in the value of these properties is dependent upon several factors, the main factor being whether or not anticipated improvements in economic conditions materialize. During the year, $7,610,000 has been appropriated from retained earnings to an owned property reserve to cover this potential exposure where the decline in value is not considered to be permanent (Note 10(b)).
>
> . . . . .
>
> 10. RETAINED EARNINGS
>
> (a) Retained earnings as at December 31, 1984 is comprised as follows:

	(thousands)
Deficit — unappropriated	$ (5,895)
General mortgage and owned property reserve	14,000
Retained earnings, December 31, 1984	$ 8,105

> Shareholders' equity as at December 31, 1984 amounted to $24,455,000. After appropriating $14,000,000 to a general mortgage and owned property reserve, surplus shareholders' equity of $10,455,000 existed as at that date.
>
> (b) The general mortgage and owned property reserve is comprised as follows:

	(thousands)
General mortgage reserve (Note 3)	$ 6,390
Owned property reserve (Note 4)	7,610
General mortgage and owned property reserve, December 31, 1984	$14,000

> In future years, as economic conditions dictate, the general mortgage and owned property reserve will be adjusted to reflect managements' best estimates of the reserves required. Realized gains and losses on the disposal of mortgages and owned property will be charged against income in the year in which they arise.

Owned property holdings for FIC, AIC and PGL on a consolidated basis were as follows:

1984

	AIC	FIC	PGL
Land held for Development	4,272,282	22,538,382	33,413,000
Income Producing Property	7,909,808	15,342,809	28,234,000
Land held for Resale	920,321	1,535,621	3,577,000

1985 (1)

	AIC	FIC	PGL
Land held for development	5,640,523	21,498,791	30,399,000
Income Producing Property	9,942,126	31,040,338	46,489,000
Land held for Resale	1,556,286	3,684,919	10,592,200

1986 (2)

	AIC	FIC	PGL (3)
Land held for development	7,752,344	34,319,794	6,325,000
Income Producing Property	19,321,852	59,716,748	7,694,000
Land held for Resale	1,319,328	2,631,286	1,510,000

(1) As restated in the draft 1986 financial statements.

(2) Draft 1986 financial statements.

(3) FIC and AIC were not consolidated within the draft 1986 consolidated financial statements. [Exhibit 276]

McCutchen testified that during the audit for 1984, significant amounts of foreclosed property were acquired by Principal Group. Johnson researched the matter and requested that McCutchen do the same. McCutchen testified that the 2 of them developed the 3 captions relating to owned property, which are quoted above. [24519] The specific wording for the accounting policies was developed by management with McCutchen's input. [24521] He also testified that the accounting policies for owned property, while now described in terms of the 3 categories, were not in his opinion, significantly different from those utilized in the previous accounting period. [24521-4]

The rationale for the categorization was that land held for resale was considered to be inventory and therefore carried at the lower of cost and estimated net realizable value. Land held for development consisted of investments maintained by the corporation beyond the short term. Income producing properties offered the corporation an opportunity of return on the investment in the form of income. Accordingly, these latter 2 categories were considered to be investments currently held on the long term basis, and thus s. 3050.29 and subsequent sections of the Canadian Institute of Chartered Accountants Handbook were considered to be applicable. [24526-33]

Working papers prepared by the auditors in June, 1985 in relation to the 1985 FIC preliminary prospectus [Exhibit 534 at 1-6] state that land held for resale was valued at the lower of cost and net realizable value, income producing properties were valued at cost on a pool basis, and land held for development was valued at cost on an individual basis. The latter 2 categories only required a write down if management was of the opinion that there was a permanent decline in value. Land held for resale was described as raw land that produced no income and had no development potential within 5 to 7 years. The other 2 classes were considered long term investments to which the handbook provisions noted above applied: income producing property was held to earn income; and land held for development was held in order to develop the property and then generate income. The working paper noted that FIC had neither the financial resources nor the expertise to develop the properties itself, and would probably enter a joint venture arrangement with a real estate development company whereby FIC contributed the land and the real estate development company provided the expertise and financial resources. The working paper also stated:

> Under the regulations, FIC are entitled to hold properties for up to 7 years. Virtually all the properties in the present real estate portfolio were acquired in 1984 (1983 at the earliest). Holding these properties for up to another 6 years is a long term investment — therefore it is reasonable (and in accordance with GAAP) to treat these investments as long term and to carry them at cost. [Exhibit 534 at 2]

The working paper noted that for all 3 classes of owned property, net realizable value was determined by management (namely the individual mortgage managers, and then concurred in by Green and Johnson) taking into account the carrying value, most recent appraisals, the client's best estimate of value and the holding period required to achieve maximum value, and any other pertinent facts. The approach taken was described as follows:

> — if expect to sell within 2 years, discount expected value at date of sale by up to 10% in comparing with current carrying value in determining whether a writedown is necessary.
>
> — if expect to have to hold on to property for 4 or 5 years to get money back, there is obviously much uncertainty — so writedown to current market value.
>
> — if there is confidence that, within 2 to 4 years, FIC will be able to get their money back, but presently carrying value is below NRV [net realizable value], then retained earnings will be appropriated, to cover holding costs during that time period.*
>
> * During the year, $5,540,000 was appropriated from retained earnings to an owned property reserve to cover this potential exposure where the decline in value is not considered to be permanent.
>
> An amount of $4,650,000 was also appropriated from retained earnings to a mortgage reserve to cover potential exposure on mortgages, where the current value of the underlying security is less than carrying value, but where the shortfall is not expected to be permanent — i.e., is expected to be made up within 2-4 years. [Exhibit 534 at 3-4]

McCutchen testified that the expected sale price for the purposes of properties expected to be sold within 2 years, was normally based on a calculation of what real estate "used to be at the height of the real estate market before the drop." [24557]

The working paper [Exhibit 534 at 5-6] noted that 63% of the mortgage portfolio was in arrears over 90 days, and that the provision for losses, both on mortgages and real estate, amounted to $2,900,000, approximately 1.8% of the "exposed assets". The author of the working paper noted that the loss provision appeared to be low in comparison with other western Canadian companies, but considered the following:

1. FIC generally has "very good" security against the loans, better than most other companies "in the same boat";
2. The "Principal Group of Companies" has the financial resources to hold the properties for a long time: an unused line of credit with the bank of $500,000,000, and the fact that Donald Cormie had large financial resources himself;
3. FIC had no debt against the properties and accordingly, there was no cash outflow associated with holding them;
4. Donald Cormie, Johnson and Green were knowledgeable and competent managers;
5. The client was optimistic that the western Canadian economy was picking up again.

The valuation techniques applied by Principal Group may be illustrated by a number of examples. The Pawluk mortgages [Exhibit 534 at 34-8] were a group of mortgages securing loans advanced by FIC and AIC. As at December 31, 1984, the aggregate balance outstanding was $23,023,825, the loans were in default, and the appraised value of the aggregate security, after deducting prior charges, was $28,897,000. Most of the appraisals were dated from October, 1981 to May, 1982 which was, according to the working papers, roughly the period in time in which land values hit their highest point. The auditors estimated that current value of the security was probably $17,000,000. Thus there was a $6,000,000 shortfall from book value. Some of the properties were considered prime real estate, and the auditors estimated that "when the economy picks up again, these will be amongst the first to take off" and that "there is no doubt that, given time, these properties will recover their former values". On all of the properties except 1 (the Rimrock Inn), the carrying value exceeded the original appraised value. The lenders were relying on excess equity in the Rimrock Inn to make up for the shortfalls on the other properties.

The Rimrock Inn was appraised in 1984 at a market value of $4,475,000, after depreciation ($8,200,000 before depreciation). Green and Johnson estimated the value to be $10,500,000, assuming completion of the hotel (which would cost $600,000). The auditors stated that accepting the valuation of $10,000,000 (before completion costs), there was an overall shortfall on the loans of approximately $400,000, assuming all the other properties were worth their 1981 values "which is not the case". The auditor also noted that Pawluk had appraised the Rimrock Inn recently at $12,000,000.

FIC and AIC accrued and recognized $4,500,000 as interest income on these loans in 1984, despite the fact that no payments were received during the year. A so-called appropriation of retained earnings of $2,500,000 had been made for the year ended 1984 in relation to these loans to cover holding costs until the situation resolved, although for the year, it was not nearly enough to make up for the additional $4,500,000 in interest. [illegible] auditor felt it was "very imprudent" that $4,500,000 had been accrued; however, given "the prime properties concerned", he felt that given "a few (maybe 4-5) years" the companies would be able to get out of this situation without a loss.

In a subsequent review it was noted that interest continued to accrue in 1985. This time the continuing accrual was noted as "extremely imprudent". Although Green felt the additional $2,200,000 accrual was very doubtful in terms of whether the interest was collectible, only 50% of that amount had been reserved (that is, a write down was made on the loan balance with a corresponding reduction in income) and the auditors were told that Donald Cormie was adamant that the Principal Group would collect all the interest on the debt.

With another mortgage then in default [Exhibit 534 at 54] the auditors concluded that as at December 31, 1984 the short fall between carrying value and market value was $320,000. However, the properties were located in Edmonton and the audit conclusion was that:

> . . . as a result of the location of these properties, the value of this property will likely be retained and therefore the property is not materially overstated at December 31/84 *Adequate security exists in the future market*. [Emphasis added.]

Another example of this methodology, where expectations as to the future market are the reason for not booking a write off or even an appropriation, is the following:

> This property is situated in a very good location and is expected to be held on to for a number of years. Value is expected to increase in the next few years, thus providing adequate security. [Exhibit 534 at 64]

It was noted that after the year end, FIC had acquired the property and apparently had to pay $520,000 to the first mortgagee to do so.

A review of the audit working papers in evidence also shows that valuations of some owned properties were based on development scenarios and contemplated re-zoning or sub-division. [Exhibits 538 at 26, 171; 534 at 65] There are numerous instances in the working papers where Green's valuations were relied upon. In other cases, Frazier and Donald Cormie were relied upon. [Exhibits 538 at 8, 24, 26, 40, 171] As noted elsewhere, Frazier's function was to attempt to substantiate higher values with supporting material obtained from outside parties. The auditors noted about him that ". . . Lance is normally very aggressive in his valuations". [Exhibit 541 at 104]

There are instances where management accepted some appraisals and rejected others. [Exhibits 534 at 25; 541 at 50-1; 541 at 50; 538 at 121] There are also instances where management accepted CDIC valuations and rejected others. Indeed, in one case management rejected both, on the basis that the appraisal was "garbage" and CDIC's value was "totally unrealistic":

> There is no hard evidence on which to base our opinions — other than January '84 appraisal of $1,015,000 and a CDIC '85 opinion of value of $1,300,000 . . . Donald Cormie/Bill Johnson/Lance Frazier/Bill Green/Rick Charlton all feel that they will easily get their money out.
>
> We will accept the client representations regarding value — client has been informed that more information will be required next year. [Exhibit 541 at 52]

This was written in February, 1987. The balance exceeded $2,200,000 and management were commissioning a study to ascertain the best use of the property.

The Deloitte Haskins & Sells audit manager wrote in the FIC and AIC Concluding Memorandum for December 31, 1986:

> . . . once again, we were given virtually no new information regarding values, and were requested to rely on inadequate information. Furthermore, we were led on many wild goose chases by many senior officers of the company who apparently do not believe that integrity is necessarily an asset. [Exhibit 540 at 114]

As noted in the section of this Report dealing with working out problem loans, appraisals on properties classified for development were not obtained. The prime factor in assessing the value of real estate was the assertion that the decline in value of real estate would not persist beyond 3 or 4 years. This was called in the testimony the "window". Development scenarios were in some instances utilized to support valuations attributed to properties. What was occurring was that as time passed, management was becoming less able to substantiate the values in the books.

The classification "land held for development" was used to segregate such land from raw land. Raw land was considered to be undevelopable in the long or short term and was classified as "land held for resale". The category of land held for development simply identified those properties which were "developable" land. [24530] The auditors, in a letter dated June 5, 1985 [Exhibit 372 at 246] state:

> . . . the land is held for development. The properties included in this caption were mainly zoned for development purposes. During our audit, management informed us of their intention to hold the properties as allowed under the Investment Contracts Act for up to the seven year maximum time limit. During this period, they would actively seek developers who would be interested in developing the property for the purpose of resale at the completion of the work. Conceptually, this work will be performed on a joint venture basis where First Investors Corporation Ltd. provides the land to be developed and the other venture partner provides all other required financing and management.
>
> Given the intention of the company to hold for a period of time in order to develop the properties, in our opinion the cost basis of valuation less provision for any permanent decline in value is appropriate. Further in our opinion, the provision for mortgage and owned property losses of $2,909,665 charged in the income statements is adequate.

Johnson testified [7362] that during his employment with PGL (November, 1984 to June, 1987) it did not develop any property to completion and agreed that perhaps none and likely very little property categorized as land held for development was ever dealt with as a development property but was merely evaluated as such. The property had "development potential", not necessarily to be developed by FIC or AIC, but saleable to a third party who could develop it. [7620-22] At least in 1984, not one property classed as land held for development was written down or considered to have suffered a permanent decline in value. [Exhibit 534 at 30] Only one income producing property (owned by FIC) was considered to have suffered a permanent decline. [Exhibit 534 at 30]

Johnson testified that if the decline in value was temporary, write downs were not necessary. His evidence was that, under GAAP, as long as the recovery of the decline would occur at some point in time over 3 to 4 years from the occurrence of the decline, it was temporary. [7005-7]

Located within the corporate records of Principal Group is a memorandum dated November 6, 1984 [Exhibit 269 at 1-3], authored by Johnson, and marked as being in draft form. It addresses recommended accounting policies for real estate. It states that when land is held for resale, it was considered in the nature of inventory and that losses, represented by the excess carrying value over net realizable value, should be written off. In the case of land held for development, it stated that it is not ordinarily necessary to make provision against any excess carrying value over market value, provided there was reasonable expectation that the planned investment would yield an adequate return based on carrying values. The expected return, it said, should include recovering, over a period of time, the investment in assets and all carrying costs, together with a fair yield on invested capital.

For the year ended 1985, the auditors issued a qualified opinion on the financial statements of FIC, AIC and PGL. Part of the qualification to the consolidated financial statements of PGL was as follows:

> The latest appraised value or estimated realizable value of certain owned property and property securing certain mortgages which are carried at cost was $11,584,682 less than cost at December 31, 1985. This loss in value, in our opinion, is other than temporary and in such circumstances, generally accepted accounting principles require that this loss be recognized. The effect of this departure from generally accepted accounting principles is described in Note 2(b) to the Consolidated Financial Statements. [Exhibit 274 at 1]

The FIC and AIC audited financial statements were similarly qualified. The permanent loss in value in the case of AIC was $1,751,613, and for FIC, $9,833,069.

The departure from GAAP, as described in a note to the audited financial statements of FIC and AIC, was as follows:

> As described in Note 1, the company follows the practice of valuing mortgages and owned property (except for land held for resale) at cost. Provisions have been made for possible losses on such investments where, in the opinion of management, there has been a decline in the value of the owned property or of the property securing mortgages that is other than temporary. Whether or not such declines will prove to be temporary is dependent upon several factors, the main factor being whether or not anticipated improvements in economic conditions materialize.
>
> In the opinion of management a decline in the value of the underlying security is temporary if the value can reasonably be expected to sufficiently recover in order that it equals or exceeds the carrying value within the holding period (seven years) allowed pursuant to the Investment Contracts Act, the statute under which the company is regulated.
>
> Management is of the opinion that the above accounting treatment is reasonable given that unrealized gains in the company's owned property and securities portfolios are not recognized under generally accepted accounting principles (GAAP) until realized.
>
> However, this assessment by management whether or not a decline in value is temporary so long as such assets have been held for less than seven years is not in accordance with generally accepted accounting principles which require that where there has been an impairment in value that has persisted for a period of three or four years, there is a general presumption that there has been a loss in value which is other than a temporary decline.

There was a similar note to the consolidated audited financial statements of PGL.

McCutchen testified that the audit process in relation to valuation did not change in 1985. Ultimately, decisions in relation to valuation of mortgages and owned property, and the quantum of the write downs were made with DMC Cormie. [24664] He said that the reference to "management" within the PGL, FIC, AIC financial statements, relating to the decline in value of the underlying security, meant Donald Cormie, James Cormie, Marlin, and the Principal Group board of directors. [24801] It was the evidence of Johnson that the reference to "management" within the note meant Donald Cormie and that Johnson had always instructed the Mortgage Department to base their valuations on the three to four year time horizon. [6316; 7011-3]

It was the evidence of Petracca (who became a director of FIC and AIC during 1985) that while she was aware of the qualification, she did not make the decision to depart from GAAP and was not sure who did. Normally, she said, that would be discussed at the PGL directors' level. While the decision to depart from GAAP affected the financial statements of FIC and AIC, she said she was not conscious of a decision taken by the directors of FIC and AIC on the issue. [9950-5]

Donald Cormie was involved in the matter: knowing that there might be a qualification, he wrote to the auditors with a view to having them reconsider. His evidence was nevertheless that in the case of the FIC and AIC financial statements, the reference to "management" in the note would be Johnson and therefore the origin of the note had to be Johnson. He then conceded that "I really don't know how that would originate down here". At the PGL level, his evidence was that the notes would be originated or worked out by Johnson and accepted by the PGL board of directors. [Exhibit 447 at 234-5; 17465-76]

There is ample evidence contained within the auditors' working papers that Donald Cormie was substantially involved in the ultimate valuation of mortgages and owned properties. In addition, Donald Cormie was involved in meetings with Bill Johnson, Bill Green, Rick Charlton, Lance Frazier and Christa Petracca on the subject of mortgage and real estate valuation prior to the completion of the 1985 audit. Johnson wrote in a memorandum dated March 27, 1986 concerning such a meeting which had been held on March 26, 1986: [Exhibit 269 at 22-3]

> . . . the Auditors have requested certain reserves to be booked in the financial statements of FIC and AIC and the valuations given to the Auditors by the Mortgage Department were lower than DMC thought they should be. Lance Frazier has been attempting to increase the values by doing certain pro formas and proposed development schemes and has presented this information to the Auditors for their perusal. In general, the Auditors intend to rely more on the Mortgage Department's valuations that [sic] they do on Lance Frazier's simply because Lance's pro formas are not backed up by third party opinions.
>
> Because of the fact that the Auditors revert to the Mortgage Department and their people for a final consencus [sic] of value, the write-downs requested by the Auditors are significant. Because of that, DMC felt the meeting was necessary whereby he would try to convince the Mortgage Department people (specifically Bill Green and Rick Charlton) to "alter" their values so that the reserves requested by the Auditors would be less. Bill Green and Rick Charlton impressed upon DMC that they felt they had gone as far as they could on the properties — that is, they had in fact tried to project a value three to four years down the road, rather than a current liquidation value. Much discussion ensued about general items and certain specific properties that DMC was familiar with and had viewed before and how he went about his own valuations. In other words, my opinion was that he was trying to pressure the Mortgage Department people into altering their long term values. He then suggested that the Mortgage Department, and not Lance Frazier, attempt to obtain third party letters of opinion or appraisals that supported values higher than what the Mortgage Department gave. He insinuated that even though these may not be right values and the Mortgage Department may in fact be right, we needed third party information on the files so the Auditors could look at it and accept it. He wanted the Mortgage Department

> people to do it rather than Lance because the Auditors had more reliance on the Mortgage Department than on Lance Frazier. More general discussion ensued and then DMC left the meeting.
>
> [Note: the reference to DMC within the quotation means Donald Cormie]

The memorandum went on to note that Green was not prepared to obtain letters of opinion because most of them would not support the values that were recorded in the books in any case, making it a futile exercise.

Donald Cormie testified that the suggestion that he was trying to get the Mortgage Department to alter its values was not quite fair, but certainly, he said, he was trying always to get the department not to write the values down if there was any way that they could justify not doing so. [19643-4]

Donald Cormie's evidence was also that his view, going back at least to June, 1984, was that owing to the seven year holding provision in the *ICA*, a property ought to be evaluated for the purposes of a company licensed under that statute by considering its value over a period of seven years. [19650-1]

I find that the departure from GAAP in relation to real estate valuation was founded upon Donald Cormie's position on the time frame for valuation of the properties. While the note may have been reviewed by Johnson, it was Donald Cormie who originated the policy and required that it be the policy of PGL, FIC and AIC.

5. CHANGE IN ACCOUNTING POLICY BETWEEN 1983 AND 1984

Pennock gave evidence that owned property was (on a pooled basis) valued at the lower of cost and market value. McCutchen stated that he did not think such was the way Principal Group was doing it upon his arrival in 1984. Johnson testified that the three categories were reflective of what had been going on prior to his arrival at PGL in late 1984. [6238-40] However, he testified that whether the change involved any difference in valuation technique was not an analysis that he carried out. [6919-20] He also said: [7089-90]

> Q Well I don't want you to speculate on why your auditors did or didn't do anything. I'm asking you sir, as a chartered accountant, as the Vice President of Finance, as a person who is familiar with the financial records of the company, from 1983 to 1984 there is a change in the way that real estate is valued on the financial statements of the company. And if there is a change in accounting policy --
>
> A Or method of valuation.
>
> Q --or method of valuation, that should be reflected in a note, or shouldn't it, or there should be a restatement?
>
> A I think there should be a reflection in a note, yes.
>
> Q Or a restatement?
>
> A A quantification of the difference.

He also said: [7361-2]

> Q Then in 1984 statements, which you had some input into, we have the three different headings under owned property?
>
> A Yes.
>
> Q Is it fair to say that there is three different kinds of property, then, or is there just one kind of property, owned property, that is characterized three different ways?
>
> A I would say that it is fair to say there is owned property described in three different ways.

THE INSPECTOR: Treated in three different ways?

Q MR. CHAPMAN: And treated in three different ways?

A From a valuation point of view?

Q Yes.

A Yes.

Exhibit 368 at 213A is a memorandum from Christa Petracca to R. Day, dated June 26, 1984. That memorandum states:

> As you know, our owned property in AIC, FIC and PS&T is considered inventory unless it is set aside in a separate pool and we can show that it was held for long term development and the production of income versus just holding it as inventory based on satisfaction of debt.
>
> *When you set up your categories* with respect to owned property would you kindly, . . . review the attached owned property list, . . . and, for example, find out over the next month which properties have we held, for example, for approximately one year already and which ones are we earning income off. If so, what is the percentage of return, . . . As discussed, please ensure that at least back to January 1, 1984, we have for each property the gross income, operating expenditures, capital expenditures and net income. We need this no later than September 1, 1984 for management purposes.
>
> *This is important for future considerations*, including (a) establishing a category at the end of the year where we could show that we are holding properties for the production of income, which would make our owned real estate portfolio look better and (b) from the point of view that any assets disposed of out of those categories would result in a capital gain or loss verses a normal income gain or loss on an inventory type portfolio of owned property, which we now standardly show. [emphasis added]

There is no evidence that Touche Ross & Co. were provided any working papers showing that any owned property was separately pooled as being held for long term development or the production of income. It is apparent from the memorandum that by June, 1984 the categories were in the process of being created. It is reasonable to infer that they had not been previously created.

Petracca testified that by June of 1984 she had become aware (through her research into real estate companies) of three different types of classifications for owned property. She agreed that the three different classes involved different ways of valuing property, but stated that it was mainly a different method of presentation in the internal and external financial statements. [9916-20]

She also testified that she thought the auditors were already considering the values of the properties in the same fashion. The only difference was that Principal Group was not previously segregating them such that they could be identified as land held for resale, to produce income, or for development. [9920]

Donald Cormie stated in relation to the June 26, 1984 memorandum that he had not given any instructions on this matter. He also said:

> We were just looking into it at this time, and I wanted to find out [illegible] the proper treatment was from an accounting point of view.

He testified that Principal Group was still "exploring" the matter right up until Johnson was hired as Vice President, Finance in the fall of 1984. [17549]

Marlin's evidence was that the 3 categories of owned property shown on the 1984 and subsequent audited financial statements were derived by the directors of FIC and AIC in conjunction with the auditors after Johnson became Vice-President, Finance. [12877-8] Marlin's evidence was that he did not think there had been a change in the method of valuation. While the 1983 FIC and AIC audited financial statements referred to "market value", he said, that meant something different in an investment contract company than in a demand deposit taking institution, since the former had a different liability structure and had seven years to dispose of owned property. [12587-96] Moreover, Marlin said, in an unduly depressed market, the proper method of valuation must take into account a time frame for recovery. [12599-601]

Finally, Marlin, Espenberg, James Cormie and Donald Cormie (the latter 2 on behalf of PGL, as shareholder of FIC and AIC) all signed representation letters concerning the audit of FIC and AIC for the fiscal year ended December 31, 1983 dated in May, 1984 stating that owned property was valued at the lower of "cost and market". [Exhibit 447 at 19-22, 35-6, and Exhibit 501]

Donald Cormie testified [19094] that until 1984, the companies had reported the values of the real estate on a market value basis at the time of the audit. Until that time, there would not have been a large distinction between current market value and the value when considering some time horizon, and he could not recollect that it had been an area of discussion. He said that about the time of the 1983 audit, the question of whether time was a factor in determining market values started to arise. [19098] At the time, Donald Cormie was of the view that there had been a substantial drop in real estate, but that there would be a partial recovery, and he wished to make sure that the companies got the benefit of the partial recovery. This was based on a prior experience when the companies had sold a lot of real estate into the market too soon, only to see the buyer realize a large profit. He said:

> The view I had was that it had a substantial drop and that there would be a partial recovery from that substantial drop. Therefore, I was viewing it as making sure that the companies got the benefit of the partial recovery because I think as you have heard Bill Green testify in the early period when we went through something similar, we had pushed a lot of real estate into the market and it had gone up substantially later on. We had pushed it in too soon because they had, and we thought that that would be unadvisable to do that, that there was a recovery, and it just needed firming in the market. [19099]

He subsequently testified:

> The view I urged on the auditors is that we needed to take a look at a period in here whereby the value would be more accurately ascertained, over a period of time, rather than this particular time. [19104]

Donald Cormie's evidence was that he expected the market to recover in the next few years, while Touche Ross & Co. were of the view that there should not be speculation on the matter of whether the real estate was going to go up or down. [19099-100] He also testified [19114] that the idea of having 3 categories of real estate was developed by Johnson.

On May 7, 1984 during the finalization of the FIC and AIC financial statements for the fiscal year ended December 31, 1983, Donald Cormie telephoned Pennock. According to Pennock, Donald Cormie stated that Touche Ross & Co. was going a lot further than the auditors of the other financial institutions with the contingency note (i.e., the aforesaid Note 9 to the FIC and AIC audited financial statements). Donald Cormie testified as follows:

> Well, I started to look at the audited statements of other financial institutions. I was, particularly if you look at the life companies and other trust companies, I was quite concerned over the fact that there seemed to be a requirement here that these companies get current appraisals all the time to bring the properties to liquidating value, and other financial institutions that the management was taking responsibility and given the responsibility for determining reasonable values on their portfolios, and that they weren't all being required to get current appraisals and write them down right away . . . [17385]

After discussing certain industries which were allowed to average their losses, and noting that the contract companies were not allowed any such system, he continued:

> . . . I felt that not only to compound the problem by throwing imminent or immediate appraisals at the companies which were primarily liquidating values, didn't seem to be, you might say, normal treatment, but there was a lot of pressure from the regulatory people, of course, to do that. [17386-7]

It would appear that Donald Cormie's difference of opinion with the auditors arose over the meaning of the word "market" because he regarded the then current situation in the real estate market as "completely unusual". [17388-93]

Donald Cormie further testified that he felt very strongly by the spring of 1983 that book value should be considered the value of the owned properties. While denying that he established any policy, he said "I just pushed everybody to, don't write it down below book unless you have to." [17041] Donald Cormie testified:

> Q Now, we've heard a lot of evidence in these hearings that the asking price was typically at or above the book value and that was an objective to sell it not less than book value?
>
> A Yes.
>
> Q You're aware of that evidence?
>
> A Yes.
>
> Q Was that a direction in 1983, in early 1983 that came from you?
>
> A Yes, when we did the spring of '83 audit, I felt strongly that they should always look at the book value as the value. There was a tendency for people to, as I've indicated before, to write the value down and make it easy to sell. The problem with that was it threw the problem upstairs into my office because I had to handle a consolidation, then. So I started getting involved about this time into the real estate in some depth and I hired Joe Barnes, right around this time, who was a — had a real estate firm.
>
> Q Yes.
>
> A To come in and deal with that very question of what was the proper value in the marketplace. [17039-40]

He also testified that even before he realized that the market collapsed, he was of the view that if assets were to be carried at market value, so should liabilities. [17984] Of course, liabilities are not so carried pursuant to GAAP.

The mortgage department was prepared to take into account some degree of economic recovery in the valuation process. Green simply testified that he valued the assets at a level as close to book value as he could justify, and that was always an objective:

> Well, as long as I worked at Principal Group, we did our best to protect assets. [5617]

He said:

> It appeared at times like we have just gone through and are continuing to go through — where real estate is going through a correction . . . it is important that we keep the values as high as we can because we are not going to stay this way, we are not going [to] stay with a surplus real estate in Alberta. We're going to come out of it. And real estate runs in cycles. A shortage begins a surplus, and vice versa . . . . [5627]

I find that as of the fiscal year ended December 31, 1983 the companies carried the owned property for the most part at the lower of cost and market value because Touche Ross & Co. required it. I find that in 1984, the valuation of owned property changed to allow for an assumption of economic recovery in this sense: when time became an issue, Principal Group chose the least conservative method of valuation. When Donald Cormie directed the mortgage department not to write down the values unless absolutely necessary, the mortgage department began to value properties based on the assumption of some economic recovery over a 3 to 4 year time horizon. It was simply a matter of readjusting, or as the witnesses put it, "refining" the accounting policies in order to ensure that this method of valuation would be acceptable to the auditors. I find that the overall policy that time was considered a factor in the valuation of owned property, thereby allowing for an assumption that there would be an economic recovery in the future, was established by Donald Cormie and supported by Marlin, both of whom believed that FIC and AIC were fundamentally different from demand deposit taking institutions. Whether this was a change in accounting policy that should have been disclosed is not an issue I must decide.

There is evidence that by adopting this method of valuation for the 1984 year end, FIC alone was able to avoid the recognition of an additional $4,069,850 in losses, which were instead shown as an appropriation of deficit with no effect on income. [Exhibit 600 at 27; Exhibit 534 at 14-16] In the case of AIC, the figure is $1,363,925. [Exhibit 534 at 14-16; being the calculated difference between the carrying and market values shown at 16.] The valuation method employed in 1984 considered each owned property on an item-by-item basis except in the case of income producing property (which in 1984 accounted for 43% of all owned property of PGL on a consolidated basis, 40% of all of FIC's owned property, and 60% of that held by AIC). The departure from a pooled valuation for some owned properties would be expected to result in a higher appropriation because unrealized increases in value could no longer offset losses in value on other properties (how much higher is not known). However, it was the change in policy itself which allowed FIC and AIC to book the losses as an appropriation, as opposed to a write down with consequent reduction in income.

The evidence tends to show that FIC and AIC became more aggressive in their valuations in 1984 as more and more owned property came on the books. As a result the issue became increasingly important, because Donald Cormie was not prepared to record a book loss and this change was the way to accommodate his position. Investment contract companies are not permitted to develop properties or hold them over the long term for investment purposes. Under the *ICA*, the companies are obliged to dispose of their owned properties, in any event within 7 years. Thus the activity of FIC and AIC in classifying their owned properties as long term development or income producing projects is evidence tending to show violation of the *ICA*. Yet, the investment contract companies adopted policies allowing them to value portions of their owned property portfolio on the premise that such activity was permitted by the *ICA*.

6. ACCRUAL AND CAPITALIZATION OF INTEREST

The policy of Principal Group was to capitalize interest on mortgages in arrears up to the point where foreclosure action had been completed. In its July 12, 1983 management letter addressed to the audit committee of the Principal Group of Companies, Touche Ross & Co. recommended that the policy be reviewed and noted that one policy that appeared to be gaining acceptance was to cease the accrual of interest on those mortgages in arrears for 90 or more days. [Exhibit 447 at 141]

The same recommendation is made in the following year's management letter dated July 16, 1984. [Exhibit 447 at 152] In that year, Touche Ross & Co. noted that the issue had been addressed, to an extent, in cases where interest accrued on certain specific mortgages and capitalized into the loan balance was offset through a reserve which was booked monthly.

The 1984 and 1985 year end financial statements of FIC, AIC and PGL [Exhibits 272 at 18, 33; 273 at 18, 32; and 274 at 7, 20A] disclosed that where the loan principal and the interest on mortgages and collateral loans exceeded the "estimated realizable value" in 1985, the "appraised value" in 1984, of underlying security, the company provided for losses if, in the opinion of management, the recovery of the loan amount and accrued interest was doubtful.

The interest accrued on mortgages in arrears is as follows:

	1986		1985		1984		1983	
	FIC	AIC	FIC	AIC	FIC	AIC	FIC	AIC
	(in thousands)		(in thousands)		(in thousands)		(in thousands)	
Mortgage interest revenue (1)	$14 449	$3,551	$17,683	$5,463	$22,099	$7,095	$23,008	$8,208
Amount of interest accrued during the year on mortgages in arrears........	8,599(1)	2,069(1)	14,577(1)	4,687(1)	19,820(2)	5,685(2)	9,677(3)	3,419(3)
Accrued interest as a percent of mortgage interest revenue	59.5%	58.3%	82.4%	85.8%	89.7%	80.1%	42.0%	41.6%
Provision for mortgage and owned property losses (1)	$24,881	$7,151	$14,577	$3,014	$ 2,910	$ 624	$ 2,090	$ 703

(1) Audited financial statements (draft in 1986) — see Exhibits 272 and 273. 1985 has been adjusted for the qualification contained in the 1985 auditor's report. Note that the provision is to cover both principal and interest. No principal was written down until 1986.

(2) Exhibit 538 at 12.

(3) 1983 — Annual Examination — difference between 1982 and 1983 balances — see Exhibit 550 at 205, Exhibit 551 at 160.

[Source: Exhibit 600 at 10]

The amount of interest accrued was not disclosed in the financial statements for the years 1983 through 1985. In the 1986 draft financial statements, interest accrued on mortgages in arrears was disclosed as a separate line item on the consolidated statement of changes in cash position.

There could not possibly be a more aggressive policy than the one used by Principal Group. The evidence tends to show that combined with the extended time horizon on valuation, the practice was geared to provide early recognition of income and maximum deferral of losses. This created an optimistic picture of the Group's financial performance.

7. CAPITALIZATION OF CARRYING COSTS

On his arrival in 1984 Johnson determined that administrative and general operating expenses clearly identified with the development of a specific project should be capitalized. [Exhibit 269 at 2; 6239] The year end 1984 FIC and AIC audited financial statements disclosed that each company capitalized direct carrying costs on properties where the appraised value was in excess of cost, and that those direct carrying costs included interest, property taxes, legal fees and those general and administrative expenses that were clearly identifiable with specific projects. The 1985 audited financial statements for FIC disclosed that the amount capitalized in 1984 was $352,214 and in 1985, $34,114. For AIC the amounts were $82,048 in 1984 and $14,114 in 1985.

Pennock testified [23838] that taxes, maintenance costs and charges of that sort for each asset were netted against the income from that asset in the course of valuation for balance sheet purposes. Pennock testified that on aggregate, they were not significant in 1983. He stated that Principal Group had disclosed to him that it was planning to change its accounting for those items in order to move the expenses and income relating to the properties to the income statement in the future. It appears that property income exceeded property expense for the year ended 1983. [Exhibits 534 at 12A; 550 at 310-11]

For the year ended 1984 the capitalized costs of FIC in the amount of $352,214 were credited to income-producing property (income), increasing the reported income from properties to $412,620.38. [Exhibit 534 at 12A] The actual net income on this class of properties (including recognition of depreciation expense) for 1984 was $60,406. [Exhibits 534 at 12A; 550 at 310-11]

In 1985, the capitalized amount of $34,114 was again credited to income. [Exhibit 541 at 111] In 1986, the cumulative amount of $386,328 was written off. [Exhibit 541 at 109]

The applicable working papers for AIC are not in the evidence. The corresponding figures for reported income shown on the balance sheet for AIC are $14,114 for 1985 and $82,048 for 1984. As was the case for FIC, capitalized carrying charges were taken into revenue in the same fashion as for FIC in 1984. It follows that in 1984, actual income from the properties was the reported income ($138,874) less capitalized charges ($82,048), or $56,826. [Exhibit 551 at 453-54]

8. DISCLOSURE OF RELATED PARTY TRANSACTIONS

The Canadian Institute of Chartered Accountants Handbook states: [Exhibit 528 at 69]

> Disclosure of related party transactions should include the following information:
>
> (a) a description of the nature and extent of transactions;
>
> (b) a description of the relationship;
>
> (c) amounts due to or from related parties and, if not otherwise apparent, the terms of settlement.

The following outlines how related party transactions were dealt with in the financial statements of various members of Principal Group. The transaction numbers are the same as those used in the section of this Report describing certain significant transactions.

(a) TRANSACTION #1

In March, 1984 FIC and AIC entered into a transaction with PS&T to acquire certain of PS&T's mortgage and owned property interests for book values, approximately $23,000,000. The FIC financial statements for the year ended 1983 noted that the company had suffered an increased contingency for loss by entering into this transaction. The audit opinion to the PS&T financial statements [Exhibit 277] noted that all of the company's transactions which had come to the notice of the auditors were within its powers, with the possible exception of this transaction.

According to the audited financial statements of FIC this transaction increased FIC's exposure to loss by $4,600,000. Based on CDIC figures, the exposure exceeded $6,000,000 and based on government of Alberta figures, the exposure was within a range of $6,300,000 to $11,300,000. No mention is made of the transaction in the FIC 1984 audited financial statements.

McCutchen testified [24569] that after reviewing the transaction, he judged that it was simply a positioning transaction to complete the Carma transaction (Transaction #3). Since the investment contract companies were exchanging assets with an unrelated party in Transaction #3, it was not "technically" a related party transaction. McCutchen testified that he received this indication from James Cormie. [24570] McCutchen acknowledged in hindsight that Transaction #1 ought to have been disclosed as a related party transaction in the 1984 audited financial statements of FIC.

There is no evidence that any recipient of the FIC financial statement was unaware of the transaction. There may well be other provincial regulators who received the financial statements but were unaware of the transaction. This was not a matter pursued in the evidence. The PGL consolidated audited financial statements would not, in any case, have required this disclosure since the transaction netted out among the subsidiaries and no intercorporate gains were booked.

(b) TRANSACTION #2

In December, 1984 PGL issued $12,500,000 PGL preferred shares to AHL. The purchase was funded by PGL advancing the necessary funds to CSL, which advanced them to AHL, which in turn paid PGL. AHL was a subsidiary of CSL and an affiliate of PGL.

McCutchen was aware of the transaction when he audited PGL for the year ended 1984. It was a related party transaction not disclosed in the notes to the financial statements, and McCutchen testified that it was an oversight on the part of Deloitte Haskins & Sells in failing to request management to disclose it. [24574]

PGL consolidated audited financial statements for the year ended 1984 were contained in a published 1984 PGL Annual Report. [Exhibit 186] Those statements show shareholders equity in the amount of $24,445,000. Note 9 to those financial statements states that some preferred shares were issued for a cash consideration of $12,500,000. There is no disclosure of the source of the cash, nor of the identity of the purchaser. The shareholders' equity section of the balance sheet directs the reader's attention to Note 10. According to Note 10 to those financial statements: [Exhibit 186 at 25]

> Shareholders' equity as at December 31, 1984 amounted to $24,455,000. After appropriating $14,000,000 to a general mortgage and owned property reserve, surplus shareholders equity of $10,455,000 existed as at that date.

Had this transaction not been undertaken, there would be no surplus shareholder's equity, but rather a deficit of $2,055,000.

(c) TRANSACTION #3

In June, 1984 FIC and AIC transferred certain of their assets to Allarco Group Limited, or its subsidiaries and affiliates, in exchange for an offshore bank, a financing company and an oil company. The 3 assets received were placed in AHL, and FIC and AIC ultimately acquired $36,340,000 of AHL preferred shares.

The consolidated and published PGL financial statements for the year ended 1984 [Exhibit 186] disclose in Note #2 that PGL's security holdings included stocks in the amount of $71,546,000 (cost) and $64,409,000 (market). Since Principal Group considered the cost of AHL shares to equate to their market value, 50.9% (cost basis) and 56.5% (market basis) of the PGL stock holdings on a consolidated basis consisted of preferred shares of its affiliate AHL.

There was no disclosure in the PGL consolidated audited financial statements for the year ended 1984 that PGL held any AHL preferred shares.

The notes to the PGL consolidated financial statements audited by Touche Ross & Co. for the year ended December 31, 1983 (which were never published by PGL) stated as follows:

> 13. Subsequent events
>
> On June 29, 1984, the Company and certain subsidiaries consummated a transaction that resulted in the surrender of certain assets to an arm's length third party in exchange for $36,340,000 of redeemable preferred shares of an affiliated company with a minimum 4% dividend rate and $15,200,000 in 6% non-recourse agreements for sale from the third party. In the opinion of the company's legal council [sic], these shares are qualified investments for the subsidiary companies registered under the Investment Contracts Act (Alberta). The assets surrendered included cash of $15,200,000, real estate

valued at $23,360,000, corporate debentures valued at $9,210,000 and mortgages valued at $7,800,000. A gain of $3,873,000 was recorded on the transactions. [Exhibit 274 at 44]

The PGL financial statements for the year ended 1984 contain no mention of these facts.

McCutchen testified [24576-7] that while the transaction was not a related party transaction, disclosure of intercorporate holdings was required in the securities section note to the financial statements. McCutchen testified that he did not recall why such disclosure was not made and noted that it was not because the facts were not disclosed to him by management. Disclosure was made in the financial statements for the years ended 1985 and 1986 (draft). For the years 1983 through 1986, only the 1984 financial statements had been publicly released in the form of an annual report.

(d) **TRANSACTIONS #7 AND #9**

In 1984 PGL "forgave" a certain proportion of administrative fees and subordinated note interest charged of FIC and AIC. In 1985, these amounts were "repaid" to FIC and AIC with Matrix shares. In the case of AIC, according to the 1985 year end audited financial statements, $455,578 of administrative fees were forgiven in 1984. Also according to the 1985 audited financial statements (which show the prior year's figures) AIC reported income of $117,888 for the year ended 1984. In the case of FIC the figures are $2,758,218 and $1,040,128 respectively. The net effect of the waiver of the subordinated note interest was to reduce expenses (and therefore increase its income) for FIC by $384,401, and for AIC by $356,000. [Exhibits 606 and 607, Schedule 20] According to Exhibit 611 at 49, the effect on AIC due to the waiver of subordinated note interest was in the amount of $325,847. The difference between the figures in the two exhibits is not important.

The forgiveness was not disclosed in the notes to the audited financial statements of FIC and AIC for the year ended 1984. While disclosure of the forgiveness was made in the 1985 financial statements of FIC and AIC, there is no expert evidence before me that such disclosure was required.

There is no disclosure within the PGL consolidated financial statements, which were circulated to the public, that the subordinated note interest and administrative levies had during the year been paid in cash, but that PGL "forgave" them at year end by a resolution stated in a later ratifying resolution to be dated December 31, 1984. [Exhibit 283, Tab 2] There is also no evidence before me whether disclosure of the reversals was required for the years 1984 or 1985 within the consolidated financial statements of PGL.

However, in the 1984 PGL Annual Report at 10 [Exhibit 186] FIC was said to have had an excellent year, with net income of $1,040,128, while AIC was said to have had a net income of $117,888.

McCutchen testified that the entire matter of the reversal was, in hindsight, regarded by Deloitte Haskins & Sells as an area of management "manipulation" of earnings. [Exhibit 540 at 26-7; 24711-2] "Manipulation" in the sense used by Deloitte Haskins & Sells encompasses a range of conduct, from attempts to show the highest earnings, perhaps not in accordance with GAAP, to a fraudulent attempt to misstate earnings. The manipulations within PGL were characterized as "differences of opinion between management and auditors". [24826-7]

By 1985 the outstanding amounts on a cumulative basis which had been "forgiven" were $10,790,000. As noted elsewhere, on December 31, 1985 AHL assumed the indebtedness of PGL arising on the "forgiveness". In return AHL received from PGL, *inter alia*, 19,618,181 Matrix common shares at 50¢ each. AHL then paid FIC and AIC by transferring to those companies the same shares on the same day at 55¢ each. AHL realized a gain in the amount of $980,909. FIC and AIC are consolidated in the financial statements of PGL, whereas AHL is not. As a result, the increase in carrying value of Matrix shares from 30¢ (PGL's cost) to 55¢ (the investment contract companies' cost) per share was recognized in the financial statements of FIC and AIC, and in the consolidated financial statements of PGL. As well, the 1985 PGL consolidated financial statements recognized a $3,923,636 gain on the sale of Matrix shares.

In the 1985 audited financial statements of FIC and AIC, it is disclosed that these companies received common shares of Matrix, publicly traded shares, at "fair market value" from AHL, an affiliated company, in consideration for the retirement of debt in a specified amount. As well, the reversal of levies and interest is disclosed. The entire transaction is not described in a fashion which would enable a reader to determine that the two transactions were, in fact, the same transaction.

Within the 1985 PGL consolidated audited financial statements, it is disclosed that PGL transferred the shares to a related company at "fair market value" and realized a gain on the sale in a specified amount. It is also disclosed that two wholly-owned subsidiaries of PGL acquired these shares from the related company at "fair market value". It is not stated that the transaction is a part of the reversal.

It is further stated in the 1985 PGL consolidated financial statements that in the opinion of the auditors, GAAP required that the gain on sale of Matrix shares and the resultant increase in excess of cost of investment in subsidiaries over acquired equity in net assets be eliminated on consolidation. Combined with the transfer of PNI shares (see Transaction #9) income and retained earnings were overstated by $14,300,459. Accordingly, Deloitte Haskins & Sells qualified its audit opinion.

Similarly, in relation to Transaction #9, the fact that the related companies recognized substantial gains on the disposition of PNI shares to FIC and AIC was not disclosed.

Whether or not additional disclosure was required, I note that the management chose not to disclose within the financial statements of FIC and AIC:

1. In the case of Transaction #7, the origin of the debt due from AHL, and that it arose as a result of cash paid by FIC and AIC to their parent;
2. That the related companies (namely PGL and AHL) recognized substantial gains on the disposition of the Matrix and PNI shares to FIC and AIC.

As noted elsewhere in the Report, the audit qualification in the PGL consolidated audited financial statements came about owing to Donald Cormie's refusal to eliminate these gains.

9. ADDITIONAL CREDITS

The nature of FIC and AIC products, most of which carried a low fixed interest rate with theoretically discretionary additional credits, is described elsewhere in this Report. As had been the practice, additional credits for the first calendar quarter of 1984 with respect to certain additional credit term certificates, were declared by the boards of directors of FIC and AIC in advance by resolution dated December 31, 1983. They were similarly declared for the second quarter of 1984 by resolution dated March 31, 1984.

According to minutes of the meeting of the directors of FIC and AIC dated May 8, 1984, additional credits for certain certificates were cancelled from and after January 1, 1984 and no additional credits were to be credited to the account of such certificate holders until such time as quarterly additional credits on them were again declared. The certificate holders were not told that additional credits had not been declared on their certificates. By directors' minute dated June 29, 1984 the additional credits for the first and second quarters of 1984 were reinstated because, said the minute, profits were realized during the second quarter of 1984 and in particular the month of June, 1984. It was also declared that henceforth, additional credits, as declared, would be shown as being credited at regular intervals of three calendar months from the date of commencement of each certificate. The policy of FIC and AIC was now to declare additional credits after each quarter, "in order to ascertain that profits have in fact been made for that quarter, noting that the company's accounting records currently show additional credits as being credited each month." [Exhibits 390 at 13 and 535 at 10]

In fact, according to the June 30, 1984 internal financial statements, distributed in August 1984, FIC suffered a loss of about $1,700,000. Yet, additional credits were declared. Marlin stated that because unrealized security gains were not reflected until fiscal year end, internal monthly financial statements were not used to determine profitability "except in a general way" and that FIC would not wait for that statement before declaring additional credits. [12041-6] Donald Cormie testified that he recommended that the declaration be moved to the end of the quarter to enable the FIC directors to look back and see the "state" and "status" of the company. [16393-7]

The effect of the change was to defer the recording of interest expense for 1984 of approximately $2,538,000 in FIC and $803,000 in AIC (and therefore, $3,341,000 in PGL on a consolidated basis). The resulting increase in income of the same amount equated to the majority of profits reported in FIC, AIC and PGL on a consolidated basis for 1984. [Exhibits 550 at 315-6, and 551 at 458-9; Exhibit 600 at 36] No disclosure of this event is made in any of the FIC, AIC and PGL consolidated audited financial statements.

The auditor, McCutchen, did not regard this as a change in accounting policy and determined that disclosure was not necessary. [24585-6] If the client wished to add a note to the financial statements it would be reviewed for completeness and interpretation. [Exhibit 390 at 18]

Marlin testified that this decision was taken by the boards of directors of FIC and AIC in consultation with Donald Cormie and James Cormie. [12027] His evidence was that it was intended that the investment contract holders would never know of the suspension and that additional credits would be reinstated before any would have to be paid (as opposed to accrued). [12028] Those investment contract holders who were paid interest monthly were not included in the resolutions and were continued to be paid. [12029; 12033-4] He agreed with the suggestion that the primary reason for changing the timing of the declaration was to defer expenses on a one-time basis. [12045]

James Cormie testified that the parties to the decision knew that the decision would have an effect on the 1984 financial statements, but disagreed that such was an objective of the decision. [13853-4]

Donald Cormie testified [16396-7] that there were two reasons for the change: first, to allow FIC and AIC to look back at the quarter and ascertain whether additional credits should be paid, and secondly, to save the expense.

Nicholson testified [23687] that at a control committee meeting, there was discussion about changing the way the Principal Group accounted for additional credits on FIC and AIC term certificates from monthly in advance to quarterly in arrears. There would be an "income blip" in the year in which the change was made. She testified that Donald Cormie initiated the discussion and that she indicated to the meeting that there might be an audit qualification because accounting principles might not have been consistently applied. Subsequent to the meeting, James Cormie called her into his office and indicated that he wanted the change made in the accounting policy. She testified that the advice of McCutchen, after a meeting with Nicholson, Marlin, Patrick and James Cormie, was that a qualification would not be necessary if the company changed the wording on the term certificate application form.

The evidence tends to show that the primary motivation in the way this transaction was carried out was to defer an expense. If management wished to change the declaration date for management purposes, it could have adjusted its books to negate the income effect or made disclosure of this item either in its financial statements or in the commentary of the 1984 Annual Report. Instead, it was carried out in secret and on only those certificates where interest was not paid, but only accrued, so that nobody would find out. I find that the change was in fact made by Donald Cormie, James Cormie and Marlin.

10. RESERVE FOR UNCLAIMED MATURITIES

Nicholson testified that unclaimed maturities on certificates were originally recorded in a certificate reserve known as "dead accounts". That certificate reserve was recorded as a liability. She testified that at some point in either 1983 or 1984, Donald Cormie, at a control meeting, suggested that the accounting department record this amount in the books as an income item. She testified that a program was written to analyze the historical trend of that amount and there was taken into income "several hundred thousand dollars to reflect unclaimed liabilities". [23689-90]

Pennock testified that this had not been booked as income in 1983, although Donald Cormie, in the course of expressing his displeasure over the FIC and AIC financial statements during the May 7, 1984 conversation, had told him that these "dead" accounts represented a source of potential profit that could be taken into income. [23846-8; Exhibit 526 at 58] McCutchen testified that a reserve for unclaimed accumulation plans had never before been established on the books and then partly brought into income. [24938] I find that the change was made in 1984.

Evidence concerning the income effect is as follows. Deloitte Haskins & Sells utilized a form called a "Summary of Unadjusted Differences" to record potential errors in the financial statements which were not sufficiently material to warrant further investigation. In the case of FIC, McCutchen recorded in such a Summary a potential error of $337,000 relating to certificate liabilities for the year ended 1984. [Exhibit 536] He testified that this figure included matured certificates which had not been claimed and accumulation plans where the contract had not been maintained and no payments had been received for some period of time, usually in excess of 5 years. [24604-5]

The applicable working paper [Exhibit 533 at 55] shows that the figure is composed of the following:

1.	Deletes ("these are the accounts where not enough payments have been received to cover distribution costs")	$182,932.48
2.	Paid Ups ("do not reserve since 1979")	
3.	Matureds ("accounts that have matured, but have not been cashed by holder")	154,234.41
	TOTAL	$337,166.89

The working paper states:

> Due to numerous w/o's [write-offs] this year of mortgages receivable, the client decided to bring into income, certificates in delete & paid up. They are legally required to refund these plans up to seven years after no activity. The client will meet this requirement — so not in contravention. We have posted amount to SUD [Summary of Unadjusted Differences] as their [sic] is still a possibility of the amount being claimed in future years.

McCutchen testified that this was the first time the company had taken into income such amounts based on items that were in what was known as "delete", which was a contract which had not been maintained for in excess of 5 years; in the past, the company had taken into income, through another account, any amounts that had remained unclaimed in excess of 7 years. [24609] He said that for years, if an accumulation account had not been claimed after 7 years, it was taken into income. [24611-2]

In relation to why the figure of $337,000 was recorded on the Summary of Unadjusted Differences, McCutchen was asked:

> Q . . . So that's the explanation as to why it's on the errors, and that's a change in management's decision as to when to record these items as income, a change from previous years?
>
> A Yes, sir. [24615]

In cross-examination by Mr. White, he testified that bringing unclaimed accumulation plans into income had occurred irregularly in the past. [24937] A reserve had been identified by the company based on historical information concerning unclaimed amounts, but the company had not recorded such amounts as income in prior years. McCutchen agreed that there was absolutely no instance of a reserve for unclaimed accumulation plans having been established on the books and brought, in part, into income in past years. [24938]

He further testified: [24938]

> Q So that's why you don't disclose it, because its a first time, something new is being done?
>
> A It was the first time, and in my view, it was immaterial.
>
> Q Because it was only how much?

McCutchen testified that his recollection was that for FIC the amount was $337,000 in 1984, of which a certain portion he felt would be appropriate in the circumstances. For AIC, his recollection was that the amount was about $40,000.

At no time during his evidence did McCutchen suggest that some portion of the $337,000 had been taken into income in previous years; only that it was reasonable, based on the historical results of the unclaimed credits, that a certain portion could be taken into income. Nevertheless, when cross-examining Cormier, Mr. McLennan suggested that the change was not $337,000, but rather the difference between what the company had been taking in historically and what the company took in for the year ended 1984. He suggested that the figure was $337,000, less $183,000 (the deletes"), for a difference of about $154,000 (the "matureds" as opposed to the "deletes"). He entered into evidence a revised schedule [Exhibit 605] which reflected this line of thinking.

For the year ended 1986, the auditors prepared a working paper regarding areas of management manipulation of earnings in prior years. [Exhibit 540 at 26-7] In relation to the reserve for unclaimed accumulation plans, the working paper stated:

> Originally, management had set up reserves for unclaimed accums that were totally unsupported by analysis. They subsequently revised their estimates. A portion of the estimate is still unsupported in Deloitte Haskins & Sells' estimate — the difference was immaterial in 1985:

	Management's Original Estimate	Revised Estimate (A)	Per Deloitte Haskins & Sells (B)	Difference (A) — (B)
AIC	$ 203,000	$ 74,260	$ 42,462	$ 37,798
FIC	2,167,000	503,520	199,149	309,371
	$2,370,000	$582,780	$241,611	$341,169

I find that as a result of the change, the 1984 income of FIC was increased by $337,166.89, and of AIC by approximately $40,000. There is insufficient explanation of the meaning of the 1986 working paper to draw a conclusion as to the amount by which income was increased, except that it is evidence of management's attempts to show the best financial picture possible. I note that this adjustment to the books was a part of the so-called 1984 profit plan, upon which Donald Cormie received reports. [Exhibit 431 at 224; 16218-20]

11. EXTRAORDINARY ITEM

In 1984 PNI recorded an extraordinary gain in its financial statements. [Exhibit 542] Note 11 to the 1984 PNI consolidated audited financial statements discloses a gain on sale of fixed assets (net of deferred income taxes) in the amount of $2,299,000. There was a loss on disposal of discontinued operations (net of deferred income taxes recoverable). Combined, these events resulted in an increase to PNI net income from extraordinary items in the amount of $2,276,000. Because the consolidated financial statements of PGL include the accounts of various subsidiaries including PNI, approximately $1,600,000 of PGL net income for the year ended 1984 resulted from the extraordinary item occurring within PNI. [McCutchen, 24752] There was no such extraordinary item note to the PGL consolidated audited financial statements for the year ended 1984.

McCutchen testified that because PGL, as a consolidated entity, had a significant amount of "investment properties" that it was selling or holding for sale, which would be in the ordinary course of its business, and because the extraordinary item within PNI was an investment in real estate which had been sold, it was not necessary to consider the income as extraordinary within PGL on a consolidated basis. He also testified that any prudent reader of the consolidated financial statements would also read the published financial statements of the subsidiaries consolidated therein. [24792]

McCutchen testified [24934] that he and Johnson concluded that disclosure of the item within the consolidated audited financial statements of PGL was not necessary. He further stated:

> I think in my discussions with him it was the company's wish not to have an extraordinary item.

McCutchen also testified that the Canadian Institute of Chartered Accountants Handbook did not address this problem and it was a question of judgment.

Without commenting on whether or not Deloitte Haskins & Sells as auditors ought to have required that this transaction be disclosed, the financial statements are those of management and management bear ultimate responsibility for those statements. It was open to management to disclose the nature of the income.

12. CONCLUSION

The theory advanced by Donald Cormie during his testimony concerning financial policy issues was that the Vice-President of Finance was the expert in accounting matters and therefore the decision maker; that Donald Cormie's responsibility for the financial statements stopped at the PGL level; and finally, that Donald Cormie had no involvement in the financial statements and accounts of FIC and AIC unless some matter affected the consolidation of PGL.

The theory is not borne out by the evidence. Pennock, responsible for the audit of PGL and its subsidiaries for the years ended 1982 and 1983, concluded that Donald Cormie was heavily involved in the day to day operations of the Principal Group and had an acute understanding of all facets of the business. He stated:

> . . . That is also consistent with one of our — one of the things that we recognized early in the process. In fact, we recognized at back at the proposal stage of the audit, and it was really key to building our audit strategy, was that this business was no different than the majority of our practice, and that's that it was an owner-managed business, and the owner makes key decisions in owner-managed businesses. This was no different except that it was a lot larger and it was also a financial institution, which has some special considerations. [23780]

Pennock's evidence was that actual negotiations and decision making concerning losses on the mortgage portfolio were conducted in discussions with Petracca and ultimately, Donald Cormie, who would agree to the writedowns in aggregate and as allocated to each of the subsidiaries. [23815-6] The same was the case for negotiations on the write downs of owned property. [23839-40] The finalization of the financial statements of FIC and AIC for the year ended 1983 occurred at a meeting which Donald Cormie attended. Representation letters with respect to the audited financial statements of FIC and AIC were taken from the shareholder, PGL, because Donald Cormie refused to sign representation letters on behalf of FIC and AIC. Donald Cormie instead signed a representation letter in his capacity as President of PGL. [23854-61] Pennock continued as to the reasons for that representation letter:

> We were taking increasing amounts of representations from Don Cormie. He was the owner, he was the major decision-maker, and we insisted on having those representations documented by him.

McCutchen, the auditor for the years ended 1984 through 1986, gave similar evidence. For example, the format of the FIC income statement in 1985 changed from 1984 at Donald Cormie's request. [24660-1] The final decision relating to the 1985 audit qualification concerning the quantum of the write downs on mortgages and owned properties was made by Donald Cormie. [24664] McCutchen also gave this evidence:

> Q Was it your experience that Don Cormie was highly involved in the preparation of the financial statements?
>
> A I wouldn't say in the preparation of the financial statements, but in the review of the documents at year end, yes.
>
> • • • • •
>
> Q . . . In preparation of the year end statements, then, did Mr. Cormie deal with you to any degree?
>
> A Yes, sir.
>
> Q To a high degree?
>
> A At the preparation stage of the financial statements and decisions to get those numbers on an individual basis.
>
> Q Did you understand that final approvals on notes or anything in relation to the year-end financial statements came from Don Cormie?
>
> A That's correct. [24799]

As noted earlier, the references to "management" relating to the valuation of owned properties in the financial statements of FIC and AIC, meant Donald Cormie, James Cormie and Ken Marlin. [24801] It was Johnson's evidence that Donald Cormie approved all write downs. [7088]

In 1986 interest was accrued for the first time on a debenture relating to the Prince Royal Hotel. [23677-9; Exhibit 371 at 1265-71; Exhibit 541 at 84-5, 88, 110 and 126] It was the evidence of Johnson [6740-4] that recording the collateral security on the books of FIC was done retroactively in June, 1986 pursuant to instructions from Donald Cormie.

Nicholson testified as to other examples. Donald Cormie wanted subordinated notes on the internal and external financial statements of FIC and AIC shown as shareholders' equity. [23591-2] Donald Cormie approved expenditures over Petracca's spending limit in respect of FIC Property Management Limited. [23596-8] At control committee meetings, Donald Cormie stated from time to time that the systems were not capitalizing enough costs on mortgages and owned properties (assets of FIC, AIC and PS&T). [23606-8] The objective was to capitalize as much costs as possible, thereby avoiding decreases in net income (although Donald Cormie explained this as resulting from the desire to match expenses to revenues). [16218-26; 23608-9] No person could obtain a financial statement, including those of FIC and AIC, without the approval of Donald Cormie. [23610-1] Sometime in 1987, Donald Cormie indicated that he did not wish to have FIC and AIC financial statements released if they showed a loss, without his prior review. [23613-4] In March, 1987, Donald Cormie requested a certain type of disclosure on the owned property figure shown on the FIC and AIC financial statements. [23618-9]. In April, 1987 Donald Cormie authorized preparing a cheque relating to the payout of a first mortgage on an FIC property. [23620-4]

In December, 1986 Donald Cormie instructed Johnson to instantly direct his attention to: decreasing old FIC and AIC certificate liabilities, and therefore expenses; determining whether there were other situations such as the Prince Royal debenture where interest could be accrued; temporarily promoting the sale of FIC and AIC 5 year products in order to substantially increase PGL's income; and becoming more aggressive in the accumulation of interest income on mortgage loans. He also observed that the "managers" of the subsidiaries should be increasing their income by aggressively marketing the Matrix and PNI shares. [Exhibit 266 at 16]

Three conclusions can be drawn from the above as well as the evidence I heard concerning who was in control of FIC and AIC. First, the accounting policies and the nature of disclosure of transactions in the financial statements of PGL, FIC and AIC were under the control of Donald Cormie. Secondly, the accounting policies of PGL, FIC and AIC were designed to maximize reported revenue and defer or minimize reported expenses. Thirdly, minimal disclosure of related party transactions was desired.

Some of the above-discussed policies and disclosures may well be acceptable under GAAP. However, the adoption by Donald Cormie of such aggressive policies is evidence tending to show an attempt to defer recognition of problems in FIC, AIC and PGL until the last possible moment. They presented what the evidence tends to show was a picture partly real and in the main fictional. The 1984 Annual Report said: "Our 30th year was our best year ever. Earnings exceeded 4.4 million for the first time." This statement was next to a full colour picture of Principal Plaza, "with its striking glass and aluminum exterior", "one of Edmonton's most prominent business addresses". Donald Cormie emphasized in his President's Perspective the $4,418,000 net profit, a "fourfold increase from a profit of $799,000 in 1983, a year in which special reserves for mortgages and owned real estate were established", and called it a "record high". He concluded:

> Principal is renowned for its people, its innovation and its achievement. We have risen to the challenge of a rapidly changing economic and regulatory environment and thrived within it. The company is well positioned to carry out new growth strategies for even greater success in the future. Principal is the right company in the right business at the right time. [Exhibit 186, 1984 Annual Report at 3]

FIC was said to have had "an excellent year" in 1984, with a net income increased to over $1,000,000 from $143,000 in 1983. AIC was said to have a profit of approximately $117,000 in 1984 (the preceding year's loss is not mentioned). Both were said to be positioned to take advantage of exceptional investment opportunities in the North American stock and bond markets, with significant portfolios of high quality bonds, providing certificate holders with a high yielding port folio of liquid securities in support of their investments. FIC was said to hold over 52% of its assets in liquid, high yielding cash, securities and fully secured collateral loans.

In reality, the evidence tends to show, were it not for the change in valuation of owned properties, PGL would have suffered a loss of over $1,000,000. On the premise of conservative accounting policies, an additional $2,500,000 ought to be deducted from that figure for the change in accrual of additional credits. In excess of $400,000 ought to be deducted for capitalization of carrying costs on owned properties, as well as an additional $370,000 more or less for the taking into income of unclaimed certificate liabilities.

In addition, aggressive policies relating to the capitalization of interest meant recognition in income of interest accrued on mortgages in arrears in excess of $25,000,000. Approximately $1,600,000 of net income was attributable to an extraordinary gain within PNI which would never occur again, and approximately $3,900,000 was attributable to Transaction #3.

The general mortgage and owned property reserve within PGL consolidated amounted to approximately $14,000,000. After appropriating the $14,000,000 to a general mortgage and owned property reserve, surplus shareholders' equity of $10,455,000 existed as at December 31, 1984. The only reason for its existence was through the purchase by AHL of PGL preferred shares in the amount of $12,500,000, funded in the first instance by PGL. AHL, the captive buyer, was also controlled by Donald Cormie. Disclosure of this related party transaction was not made within the financial statements.

FIC increased its net income to $1,040,128 in 1984. FIC would have shown a loss had more conservative writedowns been made on the mortgage and owned property portfolio, had fees and charges paid in cash to PGL not been reversed, had capitalization of carrying costs not been recognized in income, and had the company not changed its practice in declaring additional credits and taking into income unclaimed certificate liabilities. The same is true of AIC.

The effect of the accounting adjustments for 1984 was:

	FIC	AIC	PGL	
Reported Net Income	1,040,128	117,888	4,418,000	
Less:				
Write downs avoided	(4,069,850)	(1,363,925)	(5,433,775)	(1)
Administrative levies waived	(2,758,228)	(455,578)	—	(2)
Capitalized carrying charges	(352,214)	(34,114)	(386,328)	
Change in additional credits	(2,538,000)	(803,000)	(3,341,000)	
Unclaimed liabilities change	(337,167)	(40,000)	(377,167)	
Subordinated note interest waived (net)	(384,401)	(325,847)	—	(2)
Total Adjustments	10,439,850	(3,022,464)	(9,498,270)	
Net Income (Loss) after Adjustments	(9,399,722)	(2,904,576)	(5,080,270)	

(1) Does not include write downs avoided in PS&T and therefore the figure is probably understated.

(2) Would not affect PGL on a consolidated basis.

It must again be emphasized that the above adjustments are those which are, on the evidence, quantifiable. As mentioned above, capitalized mortgage interest alone exceeded $25,000,000. Other amounts representing the PNI extraordinary gain and the gain from Transaction #3 favourably impacted income. These matters were not disclosed in the 1984 Annual Report or the financial statements appended thereto. The whole was designed, the evidence tends to show, to publish a document showing operations of the Group which looked better than was justified.

The 31st Annual Review [Exhibit 11] also spoke of PGL in glowing terms. According to Donald Cormie's remarks at 5 of the Review:

> 1985 was another outstanding year for Principal Group. In 1984, despite the overall weaknesses in the financial sector in Canada, we announced record profits of $4.4 million. In 1985 additional reserves in some of our subsidiaries reduced our profits to $607,000. For the first time, group assets under management exceeded $1 billion at year end, currently exceed $1.2 billion, and we anticipate will reach $4 billion by 1990 as our expansion continues.
>
> This accomplishment is not merely luck. Principal Group manages our clients' investments and our corporate portfolios using in depth analysis of long-term cycles and trends within our economy. By understanding these trends, we have been able to act rather than react. Our success in moving out of real estate in advance of its subsequent collapse and moving into the stock and bond market at its low points are examples of how this strategic planning works for us and our clients. We continually monitor current cycles and trends within our economy and adapt our strategies accordingly.

As to FIC and AIC, the Annual Review stated at 16:

> Corporate investments are currently concentrated in bonds and securities offering excellent liquid returns. Because of the need for a balanced portfolio of secure investments, a

> large part of these companies' assets are in government and corporate bonds as well as blue chip stocks. Management's experience and financial expertise ensure the profitability of the Companies' investments and a safe, competitive yield to the certificate holders.

As at December 31, 1985 66% of the assets of FIC were invested in mortgages, notes receivable, owned property, debts due from affiliated companies, advance commissions receivable, sundry receivables and development costs, Matrix and PNI shares, and the illiquid preferred shares of AHL. The comparable percentage for AIC is 65%.

The profitability of the company's investments, perhaps ensured by "management's experience and financial expertise", certainly was suffering. AIC lost $2,662,805 that year, and had the financial statements been prepared in accordance with GAAP, it would have lost an additional $1,751,613. FIC lost $8,448,447, and had its statements been prepared in accordance with GAAP it would have lost an additional $9,833,069. Losses would have been substantially increased were it not for the "forgiveness" of the fees and levies. AIC's deficit at the end of 1985 was $3,107,239. The general mortgage and owned property reserve was $2,476,000. FIC had a deficit of $5,459,063 and a general mortgage and owned property reserve of $8,766,000.

PGL's $607,000 profit, mentioned by Donald Cormie in his President's Perspective, and also outlined in the ten year review contained within Exhibit 11, did not disclose the audit qualification. The loss that year, in accordance with GAAP, was $25,278,141. Accrued interest on mortgages in arrears in FIC and AIC exceeded $19,000,000. The Annual Review did not disclose it, but the general mortgage and owned property reserve now stood at $12,771,000. When the 1985 results were restated in the 1986 PGL consolidated financial statements (draft) in accordance with GAAP, the statement of deficit disclosed a balance as at December 31, 1985 of $19,745,000. Yet in the 1985 Annual Review, the "highlights of the year" included shareholders' equity of $23,410,000.

The evidence tends to show that the financial statements and the manner of their disclosure in the 1984 Annual Report and the 1985 Annual Review were engineered by Donald Cormie to project not only a rosy picture of the financial condition of the companies, but in fact a picture which was, the evidence tends to show, false and misleading. These documents were the prime sources of information about the condition of the "Principal Group" available to the salesmen and through them, to the investment contract holders and purchasers of PGL promissory notes.

VII. REASONS FOR THE FINANCIAL FAILURE OF FIC AND AIC

A. INTRODUCTION

As I indicated in Chapter I, it is a term of my mandate to report on the reasons for the financial failure of FIC and AIC which will include setting forth the facts and circumstances surrounding the financial failure as well as an explanation as to how and why the investment contract companies failed.

In order to investigate this area, it is necessary to examine the operations and profitability of FIC and AIC historically and as well to consider the environmental circumstances in which they operated especially in the 1980s. The latter involves a consideration not only of the regulatory environment but also of the economic environment in Alberta.

B. OPERATIONS AND PROFITABILITY

The results of operations of FIC and AIC from 1973 through 1976 are set forth in the following 4 tables.

TABLE 1
FIRST INVESTORS CORPORATION LTD.
BALANCE SHEETS
1973-1986
(000's)

	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973
Assets														
Cash	$ 2,700	$ 2,624	$ 4,382	$ 6,391	$ 18,179	$ 20,359	$ 11,035	$10,725	$ 3,420	$ 489	$ 1,178	$ 191	$ 1,605	$ 1,711
Short Term Deposits	1,498	17,122	12,735	8,672	16,501							203		1,197
	4,198	19,746	17,117	15,063	34,680	20,359	11,035	10,725	3,420	489	1,178	394	1,605	2,908
Securities/ Loans														
Bonds, Government	19,931	32,287	44,539	33,726	26,267	24,748	22,922	16,322	12,244	12,255	13,297	7,906	5,643	5,625
Bonds, Corporate	12,753	16,555	32,476	28,236	18,101	10,478	13,075	8,392	8,407	6,364	5,054	4,377	960	668
Stocks, Arms' Length	13,365	21,392	16,885	16,797	19,569	25,384	25,882	18,579	13,262	8,065	4,938	3,943	4,884	4,561
Stocks Affiliated	49,251	49,336	28,438											
Loans, Mortgages	54,988	101,187	117,134	116,053	125,469	87,672	60,988	40,176	30,961	30,189	30,360	28,160	28,308	24,577
Loans, Collateral	42,482	23,393	29,091	23,843	4,115	3,231	2,902	2,918	2,426	2,130	1,774	1,307	2,091	483
Loans, Affiliated	7,992													
Notes, Non-Arms' Length	13,800	4,200	4,200	4,427	4,427	4,283	77	77	277	677	1,736	3,363	3,564	1,055
Notes, Arms' Length	7,500													
	222,062	248,350	272,763	223,082	197,948	155,796	125,846	86,464	67,577	59,680	57,159	49,056	45,450	36,969
Owned Property Resale	2,631	3,685	1,536	990	9,220	4,043	314		418			1,571	1,757	3,353
Land/Building	59,717	31,040	15,343	14,849										
Development Land	34,320	21,499	22,538	6,754										
Sub Total	96,668	56,224	39,417	22,593	9,220	4,043	314		418			1,571	1,757	3,353
Due from Affiliates	5,464	599	2,615	330	100	624	87	556	29	4	24	12	3	27
Sundry Deferrals	532	102	1	151	104	410	144	79	78	52	76	41	7	10
Sub Total	328,924	325,021	331,913	261,219	242,052	181,232	137,426	97,824	71,522	60,225	58,437	51,074	48,822	43,267
Other	98	20		345	435	465	290	1,699	1,643	1,872	1,759	2,194	919	338
TOTAL ASSETS	$329,022	$325,041	$331,913	$261,564	$242,487	$181,697	$137,716	$99,523	$73,165	$62,097	$60,196	$53,268	$49,741	$43,605

	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973
LIABILITIES & EQUITY														
Installment Certificates . .	$ 15,995	$ 16,553	$ 20,188	$ 20,506	$ 20,486	$ 23,304	$ 25,490	$26,047	$25,964	$25,588	$25,741	$25,462	$24,629	$23,996
Advances on Certificates . .	1,882	1,754	1,405	1,001	1,046	1,332	1,574	1,607	1,547	1,322	1,068	813	637	467
Provision for Maturity	298	443	639	943	837	740	1,033	906	1,280	1,212	1,104	1,243	1,178	1,318
Additional Credits	23,677	22,814												
Single Payment Certificates . .	275,549	272,873	286,063	225,234	206,738	139,456	97,945	63,630	40,369	24,191	22,253	19,596	17,860	14,[illegible]29
Sub Total	317,401	314,437	308,295	247,684	229,107	164,832	126,042	92,190	69,160	52,313	50,166	47,114	44,304	40,710
Accounts Payable	567	176	159	425	135	513	911	996	851	449	375	47	49	65
Due to Affiliates	9,257	322	35	510	112	2,178	3,098	1,848	161	103	106	368	315	334
Mortgages Payable	8,412	5,708	901	2,571	1,029	1,024	1,008			638	888	932	990	806
Shareholder Notes	27,568	18,000	18,000	6,427	8,427	5,283			200	600	1,500	3,000	3,000	700
Commissions Payable	211	350	194	656	531	398	334	232	246	6,618	5,583	917	135	51
Total Liabilities . . .	363,416	338,993	327,584	258,273	239,341	174,228	131,393	95,266	70,618	60,721	58,618	52,378	48,793	42,666
Share Capital .	1,336	1,336	1,336	1,336	1,336	1,336	1,336	1,336	1,336	1,336	1,336	1,336	1,336	1,336
Contributed Surplus	2	2	2	2	2	2	2	2	2	2	2	2	2	2
Retained Earnings (Deficit)	(35,732)	(15,290)	2,991	1,953	1,808	6,131	4,985	2,919	1,209	38	240	(448)	(390)	(399)
Shareholders' Equity	(34,394)	(13,952)	4,329	3,291	3,146	7,469	6,323	4,257	2,547	1,376	1,578	890	948	939
TOTAL	$329,022	$325,041	$331,913	$261,564	$242,487	$181,697	$137,716	$99,523	$73,165	$62,097	$60,196	$53,268	$49,741	$43,605

Source: Audited Financial Statements (Draft 1986) — Exhibits 548 and 272.
1985 Results are restated to show the effect of the qualification of that year.
Owned property balances for 1983 are as restated in the 1984 financial statements.
Certain balances have been grouped or reclassified for this analysis.

[Exhibit 606 at 1]

TABLE 2

FIRST INVESTORS CORPORATION LTD.
INCOME STATEMENTS
1973-1986
(000's)

	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973
REVENUE														
Interest, Other than Mortgages	$ 7,767	$ 10,868	$12,070	$ 9,797	$ 9,014	$ 7,525	$ 3,910	$ 2,550	$1,385	$1,387	$1,353	$ 817	$ 734	$ 553
Mortgage Interest	14,449	17,683	22,099	23,008	20,143	11,221	6,757	4,241	3,663	3,394	3,145	3,024	2,639	2,342
Dividends	336	723	543	707	717	1,410	1,238	672	503	300	97	87	68	90
Dividends Affiliated	1,707	1,510	718											
Income Producing Properties	(368)													
Distribution Fees	2,399	1,317	1,278	2,357										
Other	49	(137)	419	119	31	84								
Sub Total	26,339	31,964	37,127	35,988	29,905	20,240	11,905	7,463	5,551	5,081	4,595	3,928	3,441	2,985
Gain on Sale, Securities	20,085	8,486	3,643	3,815	1,610	4,572	5,553	3,092	2,311	635	77	131	(67)	132
Gain on Sale, Owned Property	(256)	(1,592)	584				(53)	116		(359)	8	(19)	307	(171)
Other							190	157	2	59	24	16	38	380
Total Revenue	46,168	38,858	41,354	39,803	31,515	24,812	17,595	10,828	7,864	5,416	4,704	4,056	3,719	3,326
EXPENSES														
Interest														
Installment Certificates	798	702	465	823	651	720								
Single Payment Certificates	11,761	11,432	10,603	8,862	8,781	12,341	8,974	4,330	2,844	2,271	2,133	1,761	1,531	1,462
Additional Credits	21,758	23,608	19,965	20,830	18,632	5,891	2,772	1,920	1,300	1,138	1,084	667	604	450
Mortgage Interest	569	57		664	774	246								
Sub Total	34,886	35,799	31,033	31,179	28,838	19,198	11,746	6,250	4,144	3,409	3,217	2,428	2,135	1,912
Sales Certificate Issuance	6,842	6,761	6,370	6,391	6,469	4,831	2,683	2,314	2,050	2,217	1,750	1,763	1,576	1,410
Provision for Losses	24,881	14,577	2,910	2,090	800									
Total Expenses	66,609	57,137	40,313	39,660	36,107	24,029	14,429	8,564	6,194	5,626	4,967	4,191	3,711	3,322
Net Income Before Tax and Adj.	(20,441)	(18,279)	1,041	143	(4,592)	783	3,166	2,264	1,670	(210)	(263)	(135)	8	4
Adjustments									(51)	31		76	12	
Net Income Before Tax	(20,441)	(18,279)	1,041	143	(4,592)	783	3,166	2,264	1,619	(179)	(263)	(59)	20	4
Income Taxes					(270)	(412)	544	501	345	(27)	11		12	
Net Income	(20,441)	(18,279)	1,041	143	(4,322)	1,195	2,622	1,763	1,274	(152)	(274)	(59)	8	4
Retained Earnings/(Deficit), Beginning	(5,459)	2,991	1,953	1,808	6,131	4,985	2,919	1,209	38	240	(448)	(390)	(399)	(403)
Adjustments	(9,832)	(2)	(3)	2	(1)	(49)	(556)	(53)	(103)	(50)	962	1	1	
Retained Earnings/(Deficit), End	$(35,732)	$(15,290)	$ 2,991	$ 1,953	$ 1,808	$ 6,131	$ 4,985	$ 2,919	$1,209	$ 38	$ 240	$ (448)	$ (390)	$ (399)

Source: Audited Financial Statements (Draft 1986) — See Exhibit 272.
1985 Results are restated to show the effect of the qualification of that year.
Certain balances have been grouped or reclassified for this analysis.

[Exhibit 606 at 16]

TABLE 3

ASSOCIATED INVESTORS OF CANADA LTD.
BALANCE SHEETS
1973-1986
(000's)

	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973
Assets														
Cash	$ 1,804	$ 929	$ 1,055	$ 1,663	$ 1,795	$ 1,399	$ 7,744	$ 3,054	$ 820	$ 50	$ 144	$ 321	$ 378	$ 1,034
Short Term Deposits		5,987	1,994	7,978	4,630							101		198
	1,804	6,916	3,049	9,641	6,425	1,399	7,744	3,054	820	50	144	422	378	1,232
Securities/Loans														
Bonds, Government	16,911	15,302	14,791	9,512	5,741	5,746	5,329	4,100	3,592	4,203	3,277	2,613	2,450	2,443
Bonds, Corporate	7,116	4,917	8,253	7,848	4,850	3,154	4,265	3,006	2,371	195	195	95		
Stocks, Arms' Length	5,588	5,409	3,993	4,039	4,821	5,939	6,903	5,694	2,507	656	227	209	173	340
Stocks, Affiliated	21,540	12,982	5,769											
Loans, Mortgages	13,036	31,590	37,202	42,629	47,303	40,403	21,851	15,077	12,214	10,551	11,162	10,416	9,946	9,767
Loans, Collateral	2,946	2,550	3,560	5,488	520	356	351	331	347	508	486	506	389	303
Loans, Affiliated	23,849													
Notes, Non-Arms' Length	1,888	354	493	622	721	849	966	1,071	1,165	1,313	1,719	1,628	1,710	1,788
	92,874	73,104	74,061	70,138	63,956	56,447	39,665	29,279	22,196	17,426	17,066	15,467	14,668	14,641
Owned Property														
Resale	1,319	1,556	920	113	2,245	665	1,153	1,380	246	141	141	786	2,050	2,010
Land/Building	19,322	9,942	7,910	5,362										
Development Land	7,752	5,641	4,272	1,335										
Sub Total	28,393	17,139	13,102	6,810	2,245	665	1,153	1,380	246	141	141	786	2,050	2,010
Due from Affiliates	221	64	553	198	53	2	3	280		3		1	4	3
Sundry Deferrals	123	38	2	37	19	110			4	2	17	3	137	189
Sub Total	123,415	97,261	90,767	86,824	72,698	58,623	48,565	33,993	23,266	17,622	17,368	16,679	17,237	18,075
Other														
TOTAL ASSETS	$123,415	$97,261	$90,767	$86,824	$72,698	$58,623	$48,565	$33,993	$23,266	$17,622	$17,368	$16,679	$17,237	$18,075
LIABILITIES & EQUITY														
Installment Certificates	$ 1,720	$ 1,946	$ 2,299	$ 2,811	$ 3,303	$ 4,268	$ 5,585	$ 6,341	$ 6,521	$ 7,292	$ 7,919	$ 8,791	$ 9,370	$10,067
Advances on Certificates	660	335	85	68	89	130	167	214	229	252	262	259	269	254
Provision for Maturity	177	215	249	242	288	362	438	478	511	566	609	659	691	737
Additional Credits	6,592													
Single Payment Certificates	118,048	93,573	85,836	80,577	67,047	51,044	40,727	24,545	13,951	6,479	5,476	5,870	6,274	6,454
Sub Total	127,197	96,069	88,469	83,698	70,727	55,804	46,917	31,578	21,212	14,589	14,266	15,579	16,604	17,512
Accounts Payable	209	16	33	295	19	43	32	154	349	1,318	1,272	285	87	113
Due to Affiliates	75	117	9	38	31	594	141	533	45	7	20	2	5	3
Mortgages Payable	1,715	1,218		656										
Shareholder Notes	5,883	4,200	2,200	2,200	1,700	800								
TOTAL LIABILITIES	135,079	101,620	90,711	86,887	72,477	57,241	47,090	32,265	21,606	15,914	15,558	15,866	16,696	17,628
Share Capital	500	500	500	500	500	500	500	500	500	500	500	500	500	500
Retained Earnings (Deficit)	(12,164)	(4,859)	(444)	(563)	(279)	882	975	1,228	1,160	1,208	1,310	313	41	(53)
SHAREHOLDERS' EQUITY	(11,664)	(4,359)	56	(63)	221	1,382	1,475	1,728	1,660	1,708	1,810	813	541	447
TOTAL	$123,415	$97,261	$90,767	$86,824	$72,698	$58,623	$48,565	$33,993	$23,266	$17,622	$17,368	$16,679	$17,237	$18,075

Source: Audited Financial Statements (Draft 1986) — Exhibits 273 and 549.
1985 Results are restated to show the effect of the qualification of that year.
Owned property balances for 1983 are as restated in the 1984 financial statements.
Certain balances have been grouped or reclassified for this analysis.

[Exhibit 607 at 1]

TABLE 4

ASSOCIATED INVESTORS OF CANADA LTD.
INCOME STATEMENTS
1973-1986
(000's)

	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973
REVENUE														
Interest, Other than Mortgages	$ 3,855	$ 3,196	$ 3,408	$ 2,294	$ 1,580	$2,244	$1,146	$ 686	$ 484	$ 355	$ 325	$ 276	$ 311	$ 412
Mortgage Interest	3,551	5,463	7,095	8,208	7,897	4,641	2,291	1,337	1,047	978	1,017	934	892	695
Dividends	16	245	139	168	133	367	331	110	64	11	3	3	4	6
Dividends Affiliated	485	403	146											
Income Producing Properties	3	(23)	138											
Other	4	54		82	53	73	52	36	3				6	(409)
Sub Total	7,914	9,338	10,926	10,752	9,663	7,325	3,820	2,169	1,598	1,344	1,345	1,213	1,213	704
Gain on Sale, Securities	6,714	3,240	1,151	1,160	590	1,372	1,520	674	197		(40)	6	(69)	(44)
Gain on Sale, Owned Property	(727)	(516)	124							(26)	1,241	(17)		388
Other												8		
TOTAL REVENUE	13,901	12,062	12,201	11,912	10,253	8,697	5,340	2,843	1,795	1,318	2,546	1,210	1,144	1,048
EXPENSES														
Interest Installment Certificates	124	48	87	163	143	159								
Single Payment Certificates	4,247	3,847	3,443	2,954	2,702	4,492	3,183	1,558	999	639	555	462	499	619
Additional Credits	7,622	7,863	6,089	6,707	6,181	2,512	1,312	573	330	256	202	159	185	146
Mortgage Interest	126				263									
Sub Total	12,119	11,758	9,619	9,824	9,289	7,163	4,495	2,131	1,329	895	757	621	684	765
Sales Certificate Issuance	1,936	1,704	1,840	1,667	1,877	1,606	757	579	538	434	492	383	348	339
Provision for Losses	7,151	3,014	624	703	250		401	184	8				18	
TOTAL EXPENSES	21,206	16,476	12,083	12,194	11,416	8,769	5,653	2,894	1,875	1,329	1,249	1,004	1,050	1,104
Net Income Before Tax and Adj.	(7,305)	(4,414)	118	(282)	(1,163)	(72)	(313)	(51)	(80)	(11)	1,297	206	94	(56)
Adjustments												204		
Net Income Before Tax	(7,305)	(4,414)	118	(282)	(1,163)	(72)	(313)	(51)	(80)	(11)	1,297	410	94	(56)
Income Taxes							(72)	(127)	(59)	(9)	299	140		
Net Income	(7,305)	(4,414)	118	(282)	(1,163)	(72)	(241)	76	(21)	(2)	998	270	94	(56)
Retained Earnings/ (Deficit), Beginning	(3,106)	(444)	(563)	(279)	882	975	1,228	1,160	1,208	1,310	313	41	(53)	3
Adjustments	(1,753)	(1)	1	(2)	2	(21)	(12)	(8)	(27)	(100)	(1)	2		
RETAINED EARNINGS/ (DEFICIT), END	$(12,164)	$(4,859)	$ (444)	$ (563)	$ (279)	$ 882	$ 975	$1,228	$1,160	$1,208	$1,310	$ 313	$ 41	$ (53)

Source: Audited Financial Statements (Draft 1986) — See Exhibits 273 and 549.
1985 Results are restated to show the effect of the qualification of that year.
Certain balances have been grouped or reclassified for this analysis.

[Exhibit 607 at 20]

As demonstrated by the tables, FIC was not historically profitable. It lost $848,623 in 1972 [Exhibit 548] and after two years of small profit, it again lost money through to 1977 (with a profit in 1976 only after an extra-ordinary item [Exhibit 548]). Since 1973, the company only made a profit without the assistance of gains from the sale of securities in 1974. (Table 2)

AIC made a profit in 1974 through 1976 notwithstanding losses and gains on the sale of securities. Thereafter, in the next ensuing 11 years it only made a profit in 1979 and 1984, and even then it did so only with the assistance of gains from the sale of securities. (Table 4)

Mortgage Loans

The unsuccessful strategy of moving into mortgage loans has been described elsewhere. Mortgages fell significantly into arrears commencing in 1980. [Exhibit 550 at 25; Exhibit 551 at 41] By July, 1981 the mortgage arrears of the investment contract companies was as follows:

STATUS	FIC	AIC
In Foreclosure	2,927,607	1,704,921
In Arrears		
1 month	129,976	
2 months	197,599	65,909
3 months	366,220	74,315
4 months	68,339	
5 months	99,890	
6 months	29,956	
Over 6 months	4,384,400	
TOTAL	8,203,987 (1)	1,845,145 (2)

(1) 13.45% of total Dec. 31, 1980 portfolio

(2) 8.44% of total Dec. 31, 1980 portfolio

According to Alberta government examiners the company did not foresee any significant losses at that time. [Exhibit 550 at 25; Exhibit 551 at 41]

At December 31, 1981 approximately $12,136,000 of FIC mortgages (13.83%) and $4,099,142 of AIC mortgages (10.14%) were in arrears 3 months or more or under foreclosure proceedings. [Exhibits 550 at 64 and 551 at 79] Thereafter, the following charts show the further development of a worsening situation:

December 31, 1982

($000s)

	FIC		AIC	
	Amount	Percent	Amount	Percent
Arrears to and including 3 months	24,315	19.02	11,485	23.49
Arrears over 3 months	19,541	15.28	6,541	13.38
Under foreclosure	31,748	24.83	10,542	21.56
	75,604		28,568	

[Exhibit 526 at 77. Figures are rounded from the original. Percentages are of total mortgage portfolio as stated in Exhibit 526 at 77. There is a small variation from the total mortgage portfolio as stated in the financial statements.]

December 31, 1983
($000s)

	FIC			AIC		
	Amount	**Percent**		**Amount**	**Percent**	
Arrears to and including 3 months	6,913	5.97	71.07	2,162	5.07	67.04
Arrears over 3 months	33,534	28.94		12,479	29.23	
Under foreclosure	48,814	42.13		16,138	37.8	
	89,261			30,779		

[Exhibit 526 at 77. Figures are rounded from the original. Percentages are of total mortgage portfolio as stated in Exhibit 526 at 77. There is a small variation from the total mortgage portfolio as stated in the financial statements.]

The figures obtained by the external auditors for FIC and AIC for the period after December 31, 1983 showed:

FIC
($000)

Payment received	**31 Dec 86**	**31 Oct 85**	**30 Nov 84**
within 1 month	15,375	28,141	38,123
within 2 months	14,622	12,967	1,642
within 3 months	1,325	1,664	1,266
within 6 months	782	4,432	12,017
over 6 months	18,844	34,549	17,171
In foreclosure	2,097	31,399	38,925
	53,045	113,152	109,143

[Source: Exhibits 534 at 85-103, 538 at 200-218, 541 at 146-186. Figures are expressed in thousands of dollars and are rounded from the original.]

AIC
($000)

Payment received	**31 Oct 86**	**31 Oct 85**	**30 Nov 84**
within 1 month	5,933	11,200	12,462
within 2 months	4,925	4,980	1,562
within 3 months	94	1,044	373
within 6 months	2,308	1,474	2,496
over 6 months	3,982	6,212	6,791
In foreclosure	2,273	8,540	11,587
	19,515	33,450	35,271

[Source: Exhibits 534 at 85-103, 538 at 200-218, 541 at 146-186. Figures are expressed in thousands of dollars and are rounded from the original.]

Mortgages in arrears 3 months or more as a percentage of total mortgage balances computed from the above are:

	FIC	AIC
1986	40.95%	43.87%
1985	62.19	48.50
1984	62.40	59.18
1983	71.07	67.04
1982	40.11	34.94
1981	13.83	10.14

NOTE: Figures for 1984 through 1986 are computed as a percentage of all mortgages in arrears, rather than as of all mortgages, because arrears balances are not available as at year ends; therefore, since mortgage balances were declining, percentage figures based on mortgage balances as at year end would be overstated. While the figures are, as a result, approximations only, they illustrate the trend.

The arrears situation improved after 1984 as large numbers of the mortgages were foreclosed on and consequently re-classified as owned property. The yield on owned property was marginal or negative.

FIC and AIC started to capitalize interest on mortgages in arrears. As noted elsewhere the policy was to accrue unpaid interest on mortgages, tack it on to the loan balance, and recognize it as income. This practice continued until the total loan balance equalled the assessed value of the security. This non-cash income is estimated as:

	FIC ($000)			AIC ($000)		
	Total Mortgage Interest	Capitalized Interest	Loss Provision	Total Mortgage Interest	Capitalized Interest	Loss Provision
1982	20,143	6,866	800	7,897	2,300	250
1983	23,008	9,677	2,090	8,208	3,419	703
1984	22,099	19,820	2,910	7,095	5,685	624
1985	17,683	14,577	14,577	5,463	4,687	3,014
1986	14,449	8,599	24,881	3,551	2,069	7,151

[Exhibits 606, 607, Schedule 3]

Mortgage interest revenue was also a significant part of total revenue. Expressed as a percentage of total revenue, it is:

	FIC (%)			AIC (%)		
	Received	Capitalized	Total	Received	Capitalized	Total
1986	12.67	18.63	31.30	10.65	14.88	25.53
1985	8.00	37.51	45.51	6.43	38.86	45.29
1984	5.51	47.93	53.44	11.56	46.59	58.15
1983	33.49	24.31	57.80	40.20	28.70	68.90
1982	42.13	21.79	63.92	54.59	22.43	77.02
1981	45.22	--	45.22	53.36	--	53.36
1980	38.40	--	38.40	42.91	--	42.91
1979	39.17	--	39.17	47.02	--	47.02
1978	46.58	--	46.58	58.33	--	58.33
1977	62.67	--	62.67	74.21	--	74.21
1976	66.86	--	66.86	39.94	--	39.94
1975	74.56	--	74.56	77.18	--	77.18

[Exhibits 606 and 607, Schedule 16A]

Owned property received on foreclosure began to escalate in 1981:

	FIC			AIC		
	Amount ($000)	Owned Property as a Percentage of Total Assets	Mortgages & Owned Property as a Percentage of Total Assets	Amount ($000)	Owned Property as a Percentage of Total Assets	Mortgages & Owned Property as a Percentage of Total Assets
1986........	96,668	29.4	46.1	28,393	23.0	33.6
1985........	56,224	17.3	48.4	17,139	17.6	50.1
1984........	39,417	11.9	47.2	13,102	14.4	55.4
1983........	22,593	8.6	53.0	6,800	7.8	56.9
1982........	9,220	3.8	55.5	2,245	3.1	68.2
1981........	4,043	2.2	50.5	665	1.1	70.0
1980........	314	.2	44.5	1,153	2.4	47.4
1979........	--	--	40.4	1,380	4.1	48.5
1978........	418	.6	42.9	246	1.1	53.6
1977........	--	--	48.6	141	.8	60.7
1976........	--	--	50.4	141	.8	66.1
1975........	1,571	2.9	55.8	786	4.7	67.1
1974........	1,757	3.5	60.4	2,050	11.9	69.6
1973........	3,353	7.7	64.1	2,010	11.1	66.1

[Exhibits 606, 607, Schedule 2]

Performing and Non-Performing Assets

Management have testified that resources were shifted to liquid securities commencing in 1983. That resulted in the following amounts (at book value):

FIC
($000)

	%	1986	%	1985	%	1984	%	1983	%	1982	%	1981	%	1980
Cash/Term Deposits..........	1.3	4,198	6.1	19,746	5.2	17,117	5.8	15,063	14.3	34,680	11.2	20,359	8.0	11,035
Government Bonds...........	6.0	19,931	9.9	32,287	13.4	44,539	12.9	33,726	10.8	26,267	13.6	24,748	16.6	22,922
Corporate Bonds.............	3.9	12,753	5.1	16,555	9.8	32,476	10.8	28,236	7.5	18,101	5.8	10,478	9.5	13,075
Non-Related Stocks	4.1	13,365	6.6	21,392	5.1	16,885	6.4	16,797	8.1	19,569	13.3	24,206	18.1	24,889
Accrued Interest/ Dividends Receivable (3)....	--	--	--	--	--	--	--	--	--	--	.6	1,178	.7	993
Sub Total	15.3	50,247	27.7	89,980	33.5	111,017	35.9	93,822	40.7	98,617	44.6	80,969	52.9	72,914
Collateral Loans														
Non Affiliated (2)..........	12.9	42,482	6.0	19,511	7.7	25,591	9.1	23,843	1.7	4,115	1.8	3,231	2.1	2,902
Affiliated (1)..............	2.4	7,992	1.2	3,882	1.1	3,500	--	--	--	--	--	--	--	--
	15.3	50,474	7.2	23,393	8.8	29,091	9.1	23,843	1.7	4,115	1.8	3,231	2.1	2,902

(1) The amount of affiliated collateral loans for the year ended 1984 was not disclosed in the financial statements. Approximately $3,500 was due from PGL. [Exhibit 550 at 290] See also PGL Minutes, Dec. 17, 1984. [Exhibit 446] Balances for the years ended 1985 and 1986 are reported in Exhibit 272 at 12. For the year ended 1985, Exhibit 550 at 364 states the balance at $3,153. For the purposes of consistency, the figure of $3,882 is used in the table. The difference between the two figures is less than .3% of total assets. As noted elsewhere, a large amount of the 1986 non-affiliated collateral loan balance arises from Transaction #10.

(2) 1986 balance includes East/West Investments and 356559 Alberta Ltd., $13,509. [Exhibit 545 at 277, 294]

(3) Separately reported on the balance sheet for the years ended 1980 and 1981. Allocated to Arms' Length Stocks in Table 1, *supra*. Exhibit 606, Schedule 7 appears to be in error by not including these figures in the Non-Related Stocks Category for 1980. The table has therefore been restated to correct the error.

[Exhibit 606, Schedules 1 and 7 (book value figures); Exhibit 272]

AIC
($000)

	%	1986	%	1985	%	1984	%	1983	%	1982	%	1981	%	1980
Cash/Term Deposits	1.5	1,804	7.1	6,916	3.4	3,049	11.1	9,641	8.8	6,425	2.4	1,399	15.9	7,744
Government Bonds	13.7	16,911	15.7	15,302	16.3	14,791	11.0	9,512	7.9	5,741	9.5	5,583	11.0	5,329
Corporate Bonds	5.8	7,116	5.0	4,917	9.1	8,253	9.0	7,848	6.7	4,850	5.2	3,076	8.8	4,265
Non-Related Stocks	4.5	5,588	5.6	5,409	4.3	3,993	4.7	4,039	6.6	4,821	10.0	5,870	13.6	6,582
Accrued Interest/ Dividends Receivable (2)	--	--	--	--	--	--	--	--	--	--	.5	310	.7	321
Sub Total	25.5	31,419	33.4	32,544	33.0	30,086	35.8	31,040	30.0	21,837	27.7	16,238	49.9	24,241
Collateral Loans														
Non Affiliated	2.4	2,946	1.9	1,825	3.4	3,057	6.3	5,488	.7	520	.6	356	.7	351
Affiliated (1)	19.3	23,849	.7	725	.6	503	--	--	--	--	--	--	--	--
	21.7	26,795	2.6	2,550	3.9	3,560	6.3	5,488	.7	520	.6	356	.7	351

(1) Affiliated loans were not disclosed on the financial statements for the years ended 1984 and 1985; however approximately $503 was due from PGL in 1984. [Exhibit 551 at 440] The figure for 1985 is reported in Exhibit 551 at 502.

(2) Separately reported on the balance sheet for the years ended 1980 and 1981. These figures are allocated to Government Bonds, Corporate Bonds and Non-Related Stocks in Table 3, *supra*.

[Exhibit 607, Schedules 1 and 7 (book value figures); Exhibit 273]

From 1983 through 1986 intercompany transactions resulted in large intercompany holdings, particularly the preferred shares of AHL. The amounts are as follows:

FIRST INVESTORS CORPORATION LTD.
ANALYSIS OF RELATED PARTY BALANCES
YEAR-ENDED BALANCES
($000)

	1986		1985		1984		1983	
	$	%	$	%	$	%	$	%
Total Assets	$329,022	100.0%	$325,041	100.0%	$331,913	100.0%	$261,564	100.0%
Related Party Assets:								
Due from affiliated Companies	$ 5,464		$ 600		$ 2,615		$ 330	
Collateral loans from affiliated Companies (4)	7,992		3,153(2)		3,500(1)			
Notes receivable	13,800		4,200		4,200		4,426	
Investments in —								
Athabasca Holdings Limited	48,008		32,553		28,438(3)			
Matrix Investments Limited			8,535					
Principal Neo-Tech Inc.	65		8,248					
Mutual Funds	1,178							
Sub Total	76,507	23.3%	57,289	17.6%	38,753	11.7%	4,756	1.8%
Related Party Liabilities:								
Due to affiliated Company	(9,257)		(322)		(35)		(510)	
Subordinated notes	(27,568)		(18,000)		(18,000)		(6,426)	
Sub Total	(36,825)		(18,322)		(18,035)		(6,936)	
Net intercompany position	$ 39,682	12.1%	$ 38,967	12.0%	$ 20,718	6.2%	$ (2,180)	N/A

(1) As noted elsewhere, FIC held collateral loans from PGL in the approximate amount of $3,500. These amounts are not disclosed in the audited financial statements. Exhibit 606, Schedule 8 has been restated to include this figure within the body of the table.

(2) 1985 Annual Examination Report. [Exhibit 550 at 290 and 364] This amount is not disclosed in the audited statements. It is reported as $3,882 in Exhibit 272 at 12. As noted elsewhere the difference between the two figures is less than .3% of total assets.

(3) See Exhibit 550 and Exhibit 272 at 21. This amount is not disclosed in the audited financial statements.

(4) At December 31, 1986, in addition to the collateral loans from affiliated companies, FIC held collateral loans from East West Canadian Investments Inc. ($9,006,000) and 356539 Alberta Ltd. (Hunter) ($4,503,000). At December 31, 1986, FIC also held notes receivable from those companies of $5,000,000 and $2,500,000 respectively. Recourse on collection by FIC was limited to Matrix shares and mutual funds. See: Transaction #10. These amounts are not included in the 1986 balances since they are not technically related party assets. However, as I concluded elsewhere, these transactions did not change FIC's position. As at year end 1986, FIC sold $15,000,000 of Matrix shares but received $7,500,000 in cash, the net being $7,500,000. Inclusion of the net amount plus the mutual fund loans increases related party assets to $97,516, expressed as a percentage, 29.6%, and the net intercompany position to 18.4%. This is a better reflection of the position then as depicted in Exhibit 606, Schedule 8.

[Exhibit 606, Schedule 8; Exhibit 272]

ASSOCIATED INVESTORS OF CANADA LTD.
ANALYSIS OF RELATED PARTY BALANCES
YEAR-ENDED BALANCES
($000s)

	1986		1985		1984		1983	
	$	%	$	%	$	%	$	%
Total Assets	$123,415	100.0%	$ 97,261	100.0%	$ 90,767	100.0%	$ 86,824	100.0%
Related Party Assets:								
Due from affiliated Companies	$ 221		$ 64		$ 553		$ 198	
Collateral loans from affiliated Companies	23,849(3)		725(1)		503(1)			
Notes receivable	1,888		354		493		622	
Investments in —								
Athabasca Holdings Limited	14,123		2,540		5,769(2)			
Matrix Investments Limited	1,660		2,255					
Principal Neo-Tech Inc.	3,109		8,187					
Principal Neo-Tech Inc. warrants	300							
Mutual Funds administered by PGL	2,348							
Sub Total	47,498	38.5%	14,125	14.5%	7,318	8.1%	820	.9%
Related Party Liabilities:								
Due to affiliated Company	(75)		(117)		(9)		(38)	
Subordinated notes	(5,883)		(4,200)		(2,200)		(2,200)	
Sub Total	(5,958)		(4,317)		(2,209)		(2,238)	
Net intercompany position	$ 41,540	33.7%	$ 9,808	10.1%	$ 5,109	5.6%	$ (1,418)	N/A

(1) 1985 — Exhibit 551 at 502; 1984 — Exhibit 551 at 440. These amounts are not disclosed in the Audited Financial Statements.

(2) Exhibit 551 at 441. This amount is not disclosed in the audited financial statements.

(3) Made up of loans to PGL ($17,589,000) and PSML ($6,260,000). [Exhibit 545 at 294]

[Exhibit 607, Schedule 8; Exhibit 273]

According to Exhibits 606 and 607 (Schedule 9), a large proportion of assets were low or non-performing by 1983. The following table expresses low and non-performing assets as a percentage of total assets:

	% FIC	% AIC
1983	40.8	41.2
1985	48.3	50.6

Exhibits 606 and 607 (Schedule 9) only presented such analysis for the years ended 1983 and 1985. If one assumes that all arm's length securities and non-arm's length mutual funds and collateral loans were performing and all owned property was low or non-performing (which assumptions are true), then the following figures can be calculated from Schedules 1 and 8 of Exhibits 606 and 607 with reference to the amounts of non-performing mortgages set out earlier and Exhibits 272 and 273:

1986
($000)

	FIC	AIC
Owned Property	96,668	28,393
Mortgages over 3 months in arrears	21,723	8,563
Related party stocks:		
AHL	48,008	14,123
Matrix	--	1,660
PNI	65	3,409
Notes Receivable	13,800	1,683
Other	6,094	344

1984
($000)

	FIC	AIC
Owned Property	39,417	13,102
Mortgages over 3 months in arrears	68,113	20,874
Related party stocks:		
AHL	28,438	5,769
Matrix	--	--
PNI	--	--
Notes Receivable	4,200	--
Other	2,616	555

The AIC note receivable maturing June 1, 1988 had been classified for all years as performing since interest payments were made. [Exhibit 611 at 49] Based on the foregoing the total non-performing assets expressed numerically and as a percentage of total assets can be expressed as follows:

	FIC		AIC	
	1984	1986	1984	1986
Total	142,784	186,358	40,300	58,175
%	43.02	56.64	44.40	47.14

These figures must be further adjusted. As shown elsewhere, the loans made in Transaction #3 were low performing. On the Agreements for Sale, neither principal nor interest was due and payments received did not cover payments made on account of taxes, insurance and miscellaneous. The interest payable on the Venture Properties mortgage was funded through an advance made by the lender to a sinking fund.

Mortgage arrears reports which were used above to determine the amounts of low and non-performing mortgages show which of these loans were classified as in arrears and which were not.

The mortgage arrears classifications used after 1983 by management are as follows:

A. payment received within a month;
B. payment received within 2 months;
C. payment received within 3 months;
D. payment received within 6 months;
E. payment received over 6 months ago;
F. in foreclosure proceedings.

[Exhibit 538 at 205]

It is necessary to reclassify any such mortgage classified as A, B or C as non-performing. The properties and their balances and classifications within the arrears reports are (in $000):

Year	Property	Classification	FIC	AIC	Deduct from Performing Assets	
					FIC	AIC
1984 (1)	All Agreements	Performing	12,626	2,574	12,626	2,574
	Venture (2)	Performing	1,661	339	1,666	339
					14,292	2,913

(1) Balances are as at June 29, 1984 and are, therefore, understated.

(2) Assumed split for the Venture Properties Mortgage between AIC and FIC based on percentage of Agreements for Sale. It appears from Exhibit 606, Appendix 3 that FIC may have advanced the entire $2,000,000. However, a Venture loan does appear in AIC's case on the 1985 arrears reports. The difference is not in any case material.

[Exhibit 534 at 85-104 shows none of the loans were classified in arrears; Exhibit 281, Tab 8 shows the balances for the Agreements for Sale]

Year	Property	Classification	FIC	AIC	Deduct from Performing Assets	
					FIC	AIC
1985	Simon Valley	D	2,058	515	--	--
	Memco	E	1,513	478	--	--
	Central	E	2,958	522	--	--
	Dunedin	A	1,462	375	1,462	375
	Facto	C	1,073	--	1,073	--
	Princess	A	3,899	973	3,899	973
	Sleep Inn	A	987	--	987	--
	Venture	A	1,733	282	1,733	282
					9,154	1,630

[Exhibit 538 at 200-18]

Year	Property	Classification		FIC	AIC	Deduct from Performing Assets (1)	
		FIC	AIC			FIC	AIC
1986	Dunedin	B	A	1,735	434	1,735	434
	Princess (1)	--	B	4,305	1,073	--	1,073
	Memco	A	E	1,742	538	1,742	--
	Simon Valley	B	E	2,391	587	2,391	--
	Central (2)	--	E	3,391	597	--	--
	Venture	E	D	1,879	299	--	--
	Sleep Inn	A	--	1,067	--	1,067	--
	Facto	C	--	1,232	--	1,232	--
						8,167	1,507

(1) Classified B on AIC report of 31 Oct. 86. Does not appear on the FIC arrears report effective 31 December 1986 because the property was transferred to owned property on December 12, 1986. The FIC balance [Exhibit 541 at 4] will therefore appear in the owned property balances and no adjustment is required.

(2) This property was transferred to owned property on December 12, 1986. Therefore, it does not appear on the FIC arrears report and the balance [Exhibit 541 at 9] is included in the owned property balances.

[Exhibit 541 at 4-11; 146-186]

The revised figures for non-performing assets are therefore:

	$(000) FIC		AIC	
	1984	1986	1984	1986
Revised non-performing Assets	157,076	194,525	43,213	59,682
Percentage of Total Assets	47.3	59.1	47.61	48.36

A similar calculation for 1985 shows:

	FIC	AIC
Owned Property	56,224	17,139
Mortgages over 3 months in arrears	70,380	16,226
Carma adjustments	9,154	1,630
Related party stocks:		
AHL	32,553	2,540
Matrix	8,535	2,255
PNI	8,248	8,187
Notes Receivable	4,200	--
Other	721	102
	190,015	48,079
Percentage	58.46	49.43

Another known transaction where the interest payments due on mortgage loans were funded by the lender was Transaction #5 [Exhibit 282] considered elsewhere in this Report. The properties were classified as low or non-performing on the mortgage arrears reports for both 1985 and 1986. The grand totals of low and non-performing assets as a percentage of total assets are therefore:

	FIC	AIC
1986	59.1%	48.36%
1985	58.46	49.43
1984	47.3	47.61
1983	40.8	41.2

C. EXPERT EVIDENCE ON OPERATIONS AND PROFITABILITY

The operations and profitability were the subject of expert evidence from Barefoot, who was called by my counsel, and Davidge, who was called by counsel for Donald Cormie, James Cormie and John Cormie.

Mortgages and Owned Property

FIC and AIC suffered from a significant proportion of non-performing mortgages. For that reason there was very little cash generated from the mortgage portfolio. [35554]

Barefoot conducted an analysis of the mortgage portfolio. His conclusion that mortgage rates charged were generally at a premium over industry rates [35570] confirmed the testimony of management witnesses on the subject. Barefoot's analysis led him to the conclusion that the company was prepared to accept a much higher degree of risk in making mortgage loans. His conclusion also confirms the testimony of management witnesses on the subject.

Barefoot concluded that non-compliance with the Department of Insurance Canada mortgage lending guidelines, the geographic concentration of the portfolio, the fact that the mortgage approval system had broken down, and the fact that management was slow to react to difficulties developing in the portfolio created significant risk for FIC and AIC. [35608]

The so-called break down of the mortgage approval system requires comment. Fuhr testified that he had brought to the attention of James Cormie and Donald Cormie that management did not meet to discuss approval of mortgages. Fuhr had no authority to remedy the matter and the Mortgage Department was within the responsibility of the Vice-President of Investments and in practice received guidance from the Investment Committee, with whom Fuhr met on a weekly basis. The conclusion I have drawn is that the overall risk level considered acceptable in mortgage lending was determined by James Cormie and Donald Cormie, who also approved many of the high risk loans (see the section on investment strategies). Had the Mortgage Committee actually met, it seems doubtful that the signing officers would have declined the very mortgages which they had in fact approved individually.

Barefoot was of the opinion that the related party transactions respecting mortgages (Transactions #1, #3, #4 and #5) were not of particular benefit to the investment contract holders, since in most cases the company either gave up liquidity for non-liquid assets or entered into transactions whereby it removed itself one step from the asset by taking a share position in between and at the same time not "limiting the recourse on the original piece of property". [35608]

Under cross-examination, Barefoot testified that certain of the transactions did not benefit the investment contract holders, but were to their detriment. Those were Transaction #1 before intervention by others, and Transaction #5. Barefoot said that he was not "totally convinced" that Transaction #3 was necessarily detrimental to the investment contract holders, although it was not of benefit. Barefoot acknowledged that in the case of Transaction #1 the portfolio of non-performing mortgages would require and incur administrative expense, which was not reflected in the $11,300,000 "capital" injection required by the Government of Alberta. [36844]

FIC and AIC accrued interest on mortgages in default and reported the same as revenue even though not received in cash. This accrual continued until the mortgage was transferred to owned property and while policy was to accrue only to the point where the loan balance equalled the value of the security, the security was valued with a view to anticipated recovery of depressed real estate values. Barefoot was of the opinion that the policy respecting the capitalization of interest was acceptable, although aggressive. [35609] He considered that owing to the significant amount of money associated with accrued interest, management ought to have considered the true cash impact on the company and its ability to sustain operations.

With the rapid increase in owned property through 1986, much of which was non-revenue producing property, the investment contract companies were not able to generate any income on a significant portion of the owned property portfolios. In certain instances, a further investment would be required to make the properties saleable. Some of the properties in fact, were a cash drain on the business. [35610]

Certificate Liabilities

Barefoot noted that commencing in 1978, FIC and AIC moved away from accumulation type instalment certificates to the term and single pay certificates. By 1982 the non-accumulation certificates were consistently over 90% by dollar volume of total certificate liabilities. He commented that interest rates were on the rise in 1978 and investors began to shop for rates, tending to purchase short term investment vehicles. Longer term products also became less advantageous with certain tax changes in 1982, and overall there was a general shift in the industry to shorter term products. As a result, FIC and AIC were exposed to a riskier situation in terms of the market place and because most of the products were of a shorter duration, they would necessarily be forced to consider the composition of their asset portfolios in order to ensure that they could meet the liabilities coming due. By 1985, 82% of the portfolio had maturities under 3 years and 42% were under 1 year. The shift exposed the company to the necessity of better matching and increased its cost of funds.

In Barefoot's opinion, because their investment products were very similar to trust company products, the operations of FIC and AIC in the 1980s resembled trust companies'. On the other hand, the *ICA* did not require that investment contract companies maintain any proportionate relationship between certificate liabilities and capital, like the capital ratio required of a trust company.

Under cross-examination Barefoot was asked whether an investment contract company was more like a life insurance company than a trust company in terms of regulation. He testified that investment contract companies were like life insurance companies in terms of their statutory requirement for reserves. FIC and AIC were more like trust companies in terms of their product, and more like life insurance companies from a distribution standpoint. He testified that life insurance companies do sell products akin to the Guaranteed Investment Certificates offered by trust companies, but that such products do not account for the majority of products sold. While they are governed by reserve rules, life insurance companies self-regulate to achieve a liability to equity base which is very consistent with the rules of trust companies. Barefoot has experience with the study of investments and products of life insurance companies.

In Barefoot's opinion, life insurance companies were less comparable to FIC and AIC than trust companies. In the case of life insurance companies, the cost of sales and administration is higher as a percentage of assets than for trust companies, generally around 3% of the liability base. That is due to the nature of the sales force. Barefoot agreed that FIC and AIC historically sold their products through a sales force, but whether that was a sensible business practice or decision given the spreads available was questionable. [36936]

Barefoot also noted that up until 1979 or 1980, there appeared to be a relationship between profit and additional credits. That relationship did not persist through the 1980s and additional credits increased at a rate different than the net income before additional credits. [Exhibit 606, 607, Schedule 17]

Generally FIC and AIC paid a rate on term products higher than competitors (trust companies and banks). In some cases, the rate was comparable; in others there was as much as a 1.6% spread on a particular term. The average difference varied between .5% and .75%. Barefoot noted that the premise was logical in that FIC and AIC were not CDIC insured, and therefore an investment in their products carried additional risk. [35627]

Barefoot also noted that funds raised by investment contract companies through single pay term certificates generally were more costly than funds of a trust company. Owing to the reserve rate and the treatment of sales and commission expenses and additional credits, the cost of the product, if liabilities remained constant, would run at approximately 3.8%. In times of growth, the cost would be less.

Barefoot also came to the conclusion that in a practical sense, additional credits were not discretionary. Most of the liabilities were short term and issued at very competitive rates. If there were a failure to pay additional credits, it would follow that there would be a flight of investment contract holders at maturity. The investment contract companies relied on reinvestment. Given the significant portfolio of foreclosed property and mortgages in arrears which were not in a position to earn income, it became doubly important that there be sufficient cash flow to ensure that the company could resolve that problem over time if possible. Barring increased capital, the cash flow had to come from selling new investment contracts, or maintaining rollovers, since there was insufficient operating revenue to cover redemptions. [35656-8]

Operating Costs and Revenues

Barefoot noted that since 1976, generally speaking, the operating costs of PGL were increasing at rates significantly above inflation. Subsequent to the collapse of the Alberta economy in 1981, PGL was able to slow the escalation, and in fact lowered its costs in 1983. However, in 1986 costs increased by 33% owing to significant increases in advertising, administration, salaries and commissions. [Exhibit 606 at 42]

During that time PGL's consolidated assets also increased substantially. While costs as a percentage of assets under administration ought to decrease as assets under administration increase, owing to economics of scale, at certain times PGL's operating expenses increased at rates out of step with the growth of the asset portfolio. Two separate trends emerged: increasing operating expenses as a percentage of assets through to 1981 and thereafter a decrease, which reversed in 1986. The major components of the cost escalation were: advertising expenses and salaries in 1977 through 1979; occupancy costs in 1980; and commission expense and depreciation in 1981. After 1981, costs began to stabilize or at least escalate at a slower rate.

Fee revenue as a percentage of assets tended to exceed total operating expenses, indicating that PGL was generally earning a cash profit on providing administrative services to the various affiliates. Barefoot conducted an analysis of this matter. Based on mark-ups charged by property management firms and Revenue Canada policy on service corporation management fees charged to related parties, Barefoot marked up the cost of providing services by 10% in one scenario and by 15% in a second scenario. The excess of administration fees charged by PGL over the related costs over the last 7 years was between $11,189,000 and $14,034,000. Given that FIC and AIC paid approximately 70% of the fees earned by PGL over the last 5 years, Barefoot concluded that it could be argued that FIC and AIC paid excess fees over the last seven years of between $7,800,000 and $9,800,000. As noted elsewhere, certain administrative fees were reversed in the years 1984 through 1986 and refunded in certain instances through the transfer of Matrix shares. Barefoot's calculations accounted for the reversal and were based on an assumed value of Matrix shares of 25¢ each (returned as repayment for levies paid in cash). The evidence of Schenkelberg was that Matrix shares were worth approximately 19.725¢ each; accordingly, Barefoot's assumption is reasonable. [35669-72]

Barefoot pointed out that the actual excess fees paid by FIC and AIC was likely higher, due to the following:

1. Since PGL's operating expenses increased rapidly until 1982, the subsidiaries may have potentially subsidized PGL's inefficiencies;
2. Some PGL operating expenses, namely the commissions on PGL notes, are properly charged to PGL alone. Those costs could not be segregated from the costs incurred on behalf of the subsidiaries. Had they been identifiable, the excess fees, as calculated, would have increased; and
3. FIC and AIC paid approximately 70% of the total fees charged, while accounting for approximately 40% to 50% of the total assets under administration by PGL.

The above figures are, in fact, a conservative estimate of the excess fees actually paid by FIC and AIC.

Davidge, the accounting expert who gave evidence at the instance of Donald Cormie, James Cormie and John Cormie prepared an analysis of operating costs and management levies. [37498-503; Exhibit 633 at 107] He concluded that for the period 1983 through 1987 the range of figures was a $1,941,000 gain to PGL to a $2,100,000 loss to PGL on providing these services, based on a 15% mark-up and including imputed interest. The calculation assumed that the levy reversal was not an expense to FIC and AIC and therefore the amounts reversed were not included in the net amount that PGL received from FIC and AIC.

As noted elsewhere, the companies used certain aggressive accounting policies to dress up their financial statements. While those policies maybe were within GAAP, it is possible on the evidence to adjust these figures and observe the actual operating results of FIC and AIC. While the income statement is a measure of income, the number of significant transactions that did not involve cash during the 1980s necessitated some adjustments, which are found in Exhibits 606 and 607, Schedule 20. Barefoot deducted:

1. Capitalized interest revenue net of provision for losses on mortgages and owned property. This is a non-cash item;
2. Non-cash related party dividend income (some dividends on the AHL preferred shares were paid with PNI shares: Transaction #9);
3. Non-cash gain on Transaction #3;
4. Unclaimed certificate holder balances taken into income;
5. Gain on sale of Matrix shares to AHL;
6. Shareholders subordinated note interest forgiven;
7. Administration fees (levies) that were forgiven;
8. Capitalized carrying charges on owned property;
9. Re-allocation of additional credit expense.

After adjustment the following results in the case of FIC:

($000)

Year	1986	1985	1984	1983	1982	1981	1980
Net income (loss) per financial statements	(20,441)	(18,279)	1,041	143	(4,322)	1,195	2,622
Adjusted measure of cash flow from operations	(30,068)	(24,517)	(24,004)	(7,444)	(10,408)	1,195	2,622

The provision for losses on mortgages and owned property (non-cash expense) was set off against capitalized interest revenue (non-cash income), recognizing that a portion of the provision in each year was made to off set capitalized revenue. The provision between the amount intended to write off capitalized interest and the amount which actually represents a decline in the value of the security cannot be segregated, and for this reason, the total set-off is the most conservative approach. During the period 1982 through 1984, capitalized revenue exceeded the provisions for losses; the two were equal in 1985; and in 1986 the provision exceeded capitalized revenue. The assumption, therefore, for 1986 was that the excess portion of the provision represented an impairment of the value of the securities.

The figures for AIC are:

($000)

Year	1986	1985	1984	1983	1982	1981	1980
Net income (loss) per financial statements	(7,305)	(4,414)	118	(282)	(1,163)	(72)	(241)
Adjusted measure of cash flow from operations	(12,482)	(7,806)	(6,949)	(2,998)	(3,213)	(72)	(241)

The AIC analysis does not include the adjustment for unclaimed certificate holder balances taken into income in 1984, which as noted elsewhere, amounts to about $40,000.

Barefoot also calculated a net cash outflow and inflow on the 20 significant transactions which are discussed elsewhere. The net cash outflow for FIC and AIC for those transactions was $63,581,864. PS&T had a net cash inflow of $19,800,000, PGL a net cash inflow of $23,940,000 and AHL a net cash inflow of $2,139,000. CSI had a net cash outflow of $16,370,000 and CSL a net cash outflow of $443,000. [Exhibits 606 and 607, Appendix 3] As noted elsewhere, these conclusions are subject to certain adjustments but are valid in the case of AIC and FIC.

For the period 1982 through 1986, the net cash outflow from Schedule 20 is in the order of $96,300,000 (the comparable figure for AIC is $33,300,000). The basic operation of the company was creating a cash outflow of significant amounts and at the same time, PGL was injecting subordinated notes to offset that to some extent. Even during that time, there was still a significant cash outflow that had to be covered.

Management

Barefoot made the following observations relating to management. First, there were no outside directors on the boards of FIC, AIC, PGL or PS&T in contrast to many financial institutions. His view was that it would have been preferable to have some outside directors on the board to provide some balance. It is recognized by financial institutions substantially more than in any other business sector in Canada that outside directors are important; there are conflicting goals between protecting depositors and shareholders, and outside directors help to provide that additional balance. [35720-2]

It was also Barefoot's opinion that there ought to have been management action or reaction commencing in late 1982 relative to the serious problem that was becoming readily apparent in the investment portfolio, primarily in the mortgage portfolio.

Regulatory Environment

Barefoot gave evidence regarding the regulatory environment and said that from a business perspective, the $500,000 required capital base in the *ICA* provided very little comfort against the risk factors and was in his opinion too low. The risk factors included the related party transactions and the types of mortgage investments made. He believed that a liability to capital ratio test would be much more applicable given the type of liability. From a business perspective, increasing the liabilities without increasing the capital base increased the risk. [35731]

Simulated Earnings Analysis

In Barefoot's opinion, one of the causal factors or reasons for the financial failure of FIC and AIC was the collapse of Western Canadian real estate. The position of counsel for the Cormie family during the hearings and in argument was that this was the sole reason for the financial failure of FIC and AIC.

Barefoot prepared a "simulated earnings analysis" [35749; Exhibit 622] in order to test the proposition as to whether or not FIC and AIC were viable business entities notwithstanding the collapse in the value of Western Canadian real estate. The simulation assumes no material real estate collapse in the early 1980s in Alberta. Would they have survived given the type of product sold and the intended cost structure?

His report is designed to determine what FIC's performance would have been had its mortgage and real estate portfolio not deteriorated and had FIC not been involved in a series of non-arm's length stock transactions but rather performed in the stock market at comparable performance to Principal Group's mutual funds portfolios.

The model constructed by Barefoot was based on actual certificate and other liability balances recorded in the audited financial statements from 1973 through 1986 (draft 1986). The model calculates the total asset balance required under s. 8 of the *ICA*, and maintains the required $500,000 capital base at all times. Actual proportions of assets were used including cash, bonds, stocks, mortgages and owned property, and other assets. The expected value of assets for each category was then calculated by multiplying the proportion of assets in each asset category by the asset base. Expected revenue from each category was calculated by applying various rates of return to each year end asset category balance. Cost of funds was based on the average of FIC's rates adjusted to reflect a premium over GIC rates offered by other financial companies. Sales and administration costs were taken from the audited financial statements. Through 1984 to 1986, forgiven expenses were included as valid costs because the original intent was correctly assumed to be that PGL was to charge and retain these fees for services rendered.

In some scenarios, revenue from distribution fees of mutual funds actually recorded by FIC are included. A loan loss provision based on an analysis of a number of national trust companies was applied in order to isolate the effect of the collapse of the Western Canadian real estate market.

The effect of any potential income tax was ignored for the purpose of simplicity, because tax losses would likely offset all income taxes.

In years where income resulted, any excess of earnings over the required capital base was assumed to be distributed by way of dividend and in years where a loss occurred, it was assumed that the parent company would inject the required capital to maintain the minimum capital base.

Inherent in the analysis is the assumption that FIC would have maintained a matched portfolio in terms of maturity of assets and liabilities.

The cost of certificate liabilities was based on a three year GIC rate. In the last several years, FIC's portfolio was structured around an average three year maturity. Applied to that rate was the average premium that FIC paid on three year contracts over GIC rates for the period September 1982 through 1987. That average premium was applied to all years.

Treasury bill, ten year bond yield, and five year mortgage rate information was derived from the Bank of Canada Review. Three year mortgage rates were not used because they are not readily available. The effect of using five year mortgage rates was generally to increase the revenue. Income was overstated and the model is conservative in its loss projections.

Revenue from marketable securities was taken from the performance of Principal's mutual fund portfolios, specifically CMF, PVF and PGF. This index slightly out-performed the Toronto Stock Exchange 300 index, and was used as a more representative simulation of the performance of the FIC portfolio given that the same group of individuals managed both FIC and the mutual fund portfolios. In fact, Principal Group did out-perform the market, subject to some ups and downs, during the period 1973 through 1986. [36900] Inherent in the model is an assumption that FIC's portfolio closely approximated the global mix of the three mutual fund portfolios. Barefoot's opinion was based on a review of the portfolios, and the assumption was fair when large related party stock transactions are excluded from the analysis.

The model is limited as follows. First, FIC investment contract rate information was readily obtainable from 1982 through April, 1987. The average premium was, however, applied back to 1973. Therefore, material distortions may be found in the model prior to 1980 when accumulation plans were the dominant liability.

Secondly, the model used average interest rates in effect for each year, which is a simplifying assumption that does not reflect actual performance. Since that assumption was applied to both assets and the liabilities, it does not impact the overall observations.

Thirdly, the model was based on year end balances. Results were calculated using average balances for one of the scenarios and no material change in results was detected.

As a result of these assumptions there are differences in simulated performance from actual performance. The major differences are due to the following:

1. During 1980 and 1981, the simulation tends to overstate income and expenses. This is not a difficulty as long as the assumption is made that the portfolios are matched in terms of

maturity, which is normal financial institution practice. In actual fact the FIC portfolio was not perfectly matched.

2. The FIC stock portfolio did not perform the same as the simulated version. For the years 1980, 1982 and 1985 the simulation out performed actual results. For the years 1981, 1983, 1984 and 1986 the reverse was true. In the case of 1984 and 1986 large related party gains were recorded which limit comparability.
3. Simulated returns on cash balances always exceeded the actual performance due to simplifying assumptions. In actual fact, cash earned very little return due to significant daily or weekly fluctuations.
4. Cost of funds in all years exceeded actual performance. The use of year end balances in the calculations tends to increase the cost of funds because the liability base was generally increasing. As well, the simulated rates were current for that year and would not reflect the tempering effect of longer term liabilities. Because the same assumptions were applied to the assets, the effect of the above two factors does not influence Barefoot's conclusions.

Barefoot concluded that scenarios 5 and possibly 6 were the most appropriate scenarios to consider the performance of FIC. Under scenario 5, a very modest loan loss provision on mortgages of .2% was applied. The head broker fees paid to FIC by reason of mutual fund sales were recorded and the subsidy paid to PCL was deducted. Mortgages were assumed to earn 2% above the NHA rates, which approximated the return on the mortgages and collateral loans for FIC. Under scenario 6, the subsidy paid to PCL was excluded, as was the head broker income.

Based on the scenarios, Barefoot concluded that it was highly unlikely that FIC was structured in manner that would permit it to be profitable without certain things occurring; most significantly, there would have to be very substantial and consistent returns in the stock market year after year. [36828] FIC would have to charge significantly higher than NHA rates on its mortgage portfolio, while at the same time ensuring that the mortgages, which carried additional risk associated with higher rates, were not going into default. There would be no margin for error in managing the overall portfolio of assets and matching them to liabilities. While the portfolio of stocks out-performed the Toronto Stock Exchange index, it was still subject to wide fluctuations, suggesting that there had to be a significant capital base to cover those fluctuations.

Until 1980, FIC would at best have operated at a marginal level of profitability, as actual results for that time indicate. Subsequent to 1980, the volatility of results and the accumulated level of losses would have increased substantially, indicating that the concept on which FIC operated after 1980 was not financially viable given the intended cost structure.

Based on the simulation, Barefoot maintained his opinion that the real estate collapse was a significant causal factor in the collapse of FIC and AIC. It was. But it was not the only factor. [36830]

A series of revised simulations were put to Barefoot. [Exhibit 624; 36986-7017; 37043-50] The revised simulations were based on actual returns on all categories of assets (except the mortgage portfolio) and actual costs on all categories of liabilities. The simulation which he concluded to be most comparable [Exhibit 624 at 6] showed new simulated total earnings for the period 1980 through 1986 of $39,779,000 compared with Barefoot's conclusion of an $8,019,000 loss. Barefoot was of the opinion that there were a number of adjustments to be made in order to make the revision comparable to his own and to normalize its analysis to reflect what was actually occurring within FIC:

1. The cost of funds in 1984 was understated by approximately $2,500,000 relating to an accounting adjustment for re-declaration of additional credits;
2. Interest forgiven through the years 1984 and 1986 should be added back because it was the intention that the money be paid in the first place (and it was);

3. The net amount of forgiven subordinated note interest should similarly be added back;
4. Collateral loan interest revenue was double counted; and,
5. The gain on sale of Matrix shares ought to be eliminated, because there is some debate on whether there was in hindsight any real gain.

With the adjustments, the $39,800,000 profit became a $4,700,000 loss. Barefoot noted various other adjustments that could have been made. The use of five-year mortgage rates created a revenue premium. There was an impairment of marketable securities by $12,000,000 on the draft financial statements for the year ended 1986 which might create some additional losses. There were a number of deferred expenses that represented cash actually paid out, which might further increase the loss. Other gains on related party transactions were recorded in the simulation. Barefoot concluded:

> So I am suggesting that using the actual numbers and my simulated real estate number it still demonstrates that this company would have lost money over the period of 1980 to 1986. [37008]

On the theory that fewer subordinated notes would be required had there been no real estate collapse, one might deduct some of the $27,000,000 of subordinated notes that were held by FIC. That would reduce the cost of funds, but as well the return on assets. There would be a small impact on the loss, which Barefoot suggested, on the assumption that $20,000,000 of subordinated notes were removed, would amount to approximately $200,000. [37045]

Davidge also prepared a simulation. [Exhibit 633 at 100-102] This simulation was based on actual numbers including reduced costs associated with the waiver of the levies and assumed certain earnings on a properly performing mortgage portfolio. In 1986, income earned from the disposition of related party shares was substituted with an estimated return of 10% (reasonably close to the bond rate over those 3 years) that would have been obtained from money that was tied up in those shares. Simulated mortgage figures were based on the NHA plus 2% rate.

Subordinated notes for the years 1984 through 1986 were eliminated from Davidge's analysis based on the assumption that with a properly performing mortgage portfolio, there would have not been the need for most of these subordinated notes; the actual cost of funds did not include cost of funds for subordinated notes.

Davidge calculated a total income for the period 1980 to 1986 of $12,800,000, compared to Barefoot's loss of $8,019,000. In Davidge's opinion FIC was, assuming a properly performing mortgage portfolio, viable during 1980 through 1986, and would have been viable subsequent to December 31, 1986 if it maintained a properly performing mortgage portfolio, the same level of returns in the stock and bond category, and the same cost of funds and of selling and administration. By viable, Davidge meant sufficient revenue to cover costs of operation and show an adequate return.

Davidge's simulated earnings analysis was in turn readjusted. The adjustments made were levies reversed in 1984 through 1986 ($9,540,000) and levies not recorded in 1983 ($1,815,000). Davidge agreed that other adjustments could be made based on what could be described as a reasonable difference of opinion among experts, resulting in an adjusted net loss over the period 1980 through 1986 of $275,000. Davidge conceded that he failed to deduct collateral loan interest from his model for the years 1980 through 1982 inclusive, and that his model was in error for those years in the amounts shown in Exhibit 634. [37537-8]. This leads to a revised loss over the period 1980 through 1986 of $1,503,000. This revision includes deduction of all subordinated notes from the model. The failure to remove them tends to over-state revenue; the company realizes a return on the asset represented by the notes, and yet has no recorded cost on those funds since interest payments were waived. [37531-43; Exhibit 634]

In his simulation, as noted above, Davidge eliminated a portion of the subordinated notes [37477] on the basis that if the mortgage portfolio were properly performing there would not have been the need for the notes. He also eliminated the cost of funds for subordinated notes from actual cost of funds. Davidge testified that he did not remove all the subordinated notes because there were some deficits at the end of years 1985 and 1986 that reduced the asset balance. [37539] Only the proportion of the notes invested in mortgages was removed. He therefore deleted from his calculation of the average mortgage balance that proportion of subordinated notes which represented the proportion of mortgages to total assets. An assumed rate was applied to the revised mortgage balance in order to arrive at deemed income from mortgages. I take from this evidence that it is very questionable that FIC would have been profitable on its intended cost structure. I have also noted that for the year 1984 Davidge has apparently understated the subordinated note balance by $11,800,000 which might have necessitated a further downward adjustment in income.

As noted above, Davidge also prepared an analysis of operating costs and management levies. He concluded that for the period 1983 through 1987, the range of figures was a $1,941,000 gain to PGL to a $2,100,000 loss to PGL on providing these services, based on a 15% mark-up from cost. The calculation similarly assumed that the forgiven amounts were not expenses and thus those amounts were not included in the net figures received from FIC and AIC. His analysis also imputed an interest cost to the provision of services. [37498; Exhibit 633 at 107]

Davidge testified [37585] that Note 1 to the 1983 audited financial statements of FIC and AIC, in conjunction with Note 9 thereof, was considered to be a going concern note. The note was clear, concise and plain on its face. He further testified [37583] that at the end of 1983, based on his review of the financial statements, and under his definition of insolvency, FIC and AIC would not have been insolvent, but absent an injection of capital, there was a likelihood of insolvency had their licences not been renewed. He agreed [37588] that Notes 1 and 9 to the 1983 FIC and AIC financial statements meant that the investment contract companies had already lost their equity, but if the real estate market turned around, they would get it back.

D. CONCLUSION

Based on the foregoing evidence, I conclude that the evidence tends to show that the collapse of Western Canadian real estate, impacting as it did upon the Alberta and British Columbia real estate market was a significant causal factor and a reason for the financial failure of FIC and AIC. I also find that the Barefoot simulated earnings analysis is evidence tending to show that the real estate collapse was not the sole or even a predominant factor because that analysis demonstrates that the investment contract companies were likely marginal operations at best, even if there had been no collapse of real estate in Alberta in the 1980s.

The evidence tends to show that the reasons for the failure of FIC and AIC are as follows:

1. Their boards of directors lacked any degree of independence from the parent company;
2. Their strategic direction in the late 1970s was inconsistent with the stated investment objectives to move away from dependence on mortgage loans;
3. Their chosen response to a changing market place resulted in significant modifications to the investment contract products (a movement to higher cost single pay and term products) which consequently forced them to seek more speculative assets that yielded higher returns;
4. Their cost and commission structure resulted in higher costs of operations than comparable institutions offering comparable products;
5. Their capital structure was inadequate and did not permit them any margin of error in managing their investment portfolio;

6. There was an inability to deal with the impact of the real estate collapse on the investment contract companies' mortgage portfolios.

   [Barefoot, 35737; 35781-6, 35900-1]

The evidence tends to show that there were three additional factors that could have prevented the failure or reduced the magnitude of the loss:

1. Consideration of the overriding business problems faced by FIC and AIC. Instead, they adopted an ill-conceived work out strategy which was directed at disguising the realities of the investment contract companies' financial situation through investments in related parties, changes in accounting practices, and the recording of non cash gains on transactions. There was no addressing of the overriding business problems that the companies faced.
2. Prompt regulatory response. The regulators failed to act when they knew that the investment contract companies' strategy, policies and practices were not protecting the investment contract holders. Regulations were inappropriate or outdated and could not effectively minimize the impact of the investment contract companies' strategies.
3. A realistic approach to qualified assets and financial statement disclosure. Instead, management of the investment contract companies were concerned with the technical interpretation of the *ICA* and with minimum financial statement disclosure over the substance and spirit of the *ICA* and GAAP.

Barefoot testified that the factors were interrelated and that it would be inappropriate to assess any particular weighting to the six factors.

In the context of an inadequate capital structure which did not permit the investment contract companies any margin of error in managing their investment portfolios, I am of the view that the statute was lacking given the product which was offered. The evidence tends to show that a significant reason for the financial failure of FIC and AIC was the absence of any adequate capitalization in response to the shift in investment certificates from accumulation certificates to single pay certificates which had been completed by the beginning of the 1980s. As stated elsewhere in this Report, at that time the fundamental structure of the investment contract companies was changed and became more akin to that of a trust company, especially when one considers the magnitude of the single pay certificates as a percentage of liabilities in the 1980s. The statute required no liability to capital ratio. The regulators tried to have management of the investment contract companies agree to abide by a liability to capital ratio. No agreement was reached and no such ratio was ever maintained in the 1980s nor did the investment contract companies even approach such a ratio.

I am of the further view that the evidence tends to show that another significant causal factor with respect to the reasons for the financial failure of FIC and AIC, especially in the context of the timing of the failure, was the wilful refusal of the regulators to act effectively when they knew that the investment contract companies' strategy, policies and practices were not protecting the investment contract holders. As is stated in the next chapter, they did not enforce the *ICA*, inadequate as it was.

The response of the investment contract companies in emphasizing single pay certificates as the result of a changing market place made the necessity for a capital ratio and trust company-like regulation acute. No such regulation was forthcoming nor was it adhered to in any practical sense.

I wish to emphasize in regard to the lack of an adequate capital structure that compliance with the statutory requirement ($500,000) does not absolve the prudent manager from "self regulating". Given the liability structure of FIC and AIC existing by 1980, some self restraint ought to have been shown. Instead, liabilities continued to escalate and indeed, some government audit section examiners concluded that the capital ratio of FIC and AIC sometimes exceeded 100:1 and owing to the lack of capital, became infinite.

At the same time, there was not any, or any significant, spread or matching, and so the investment strategy in response to the high interest rates and the inverted interest rate curve in 1981 emphasized high risk mortgages. The investment strategy pursued from 1978 through 1982 was not consistent with the stated investment objectives to move away from a dependence on mortgages and in fact emphasized high risk mortgages.

The collapse of the Western Canadian real estate market had a significant impact on the profitability of FIC and AIC. This fact cannot be discounted. However, I wish to emphasize that I accept Barefoot's evidence that FIC and AIC would not have been profitable in any event as shown by the simulated earnings analysis. The investment contract companies continually, at least from 1983, relied on gains on the sale of securities to maintain their profitability. Part of their problem occurred because of the high risk loans made in the first instance.

FIC and AIC were subject to a systematic drain on their cash resources not only in response to the adverse economic conditions of the 1980s and the Western Canadian real estate collapse but also by virtue of the payment of the "surplus" to PGL along with other administrative fees such as the fees indirectly paid through to EL&F. The drain was necessitated by PGL's own practice of lend ing its resources to its parent on either preferential interest rates or interest free. The taking of the surplus from FIC and AIC by PGL took capital from the investment contract companies which may have staved off financial disaster and enabled them to weather the economic downturn. Without earned capital and without proper levels of capitalization due to the lack of any prudent management or legislative requirement, FIC and AIC had little or no ability to meet the problems encountered as the result of the collapse of the Western Canadian economy.

The evidence tends to show that the corporate interests of FIC and AIC were sacrificed for those of PGL or the "upstairs" companies and ultimately the personal interests of Donald Cormie. This is the "how" and the "why" of the reasons for the financial failure of the investment contract companies.

VIII. THE ROLE OF THE PROVINCE OF ALBERTA

A. INTRODUCTION

An Investigation of the business or affairs of FIC and AIC, the reasons for their financial failure and their sales practices calls for consideration of the regulatory environment within which they operated. The sale of investment contracts in Alberta is regulated by the *ICA*. The *ICA* charges certain public officials with its administration. This section of the Report examines the manner in which the regulation of FIC and AIC was carried out insofar as it is relevant to the terms of my mandate.

In particular, I have considered the propriety of that regulation in the context of these questions:

1. Was the manner in which FIC and AIC were regulated a reason for their financial failure?
2. Given that certain public officials are persons concerned with the business of FIC and AIC by virtue of their involvement in regulating the sale of investment contracts, did they act fraudulently or dishonestly in that connection?
3. What effect did the manner of administration of the *ICA* have on the sales practices of FIC and AIC and their affiliates?

B. THE INVESTMENT CONTRACTS ACT

The *ICA* was first enacted in 1957. The purpose of the *ICA*, as evidenced in Bill 29 which introduced it, was as follows:

> Persons and companies engaged in Alberta in the business of issuing investment contracts now come under *The Securities Act* 1955. By the nature of the business they do, investment companies and the persons engaged in selling investment contracts are unlike companies and salesmen now falling within the purview of *The Securities Act* 1955.
>
> The purpose of this Bill is to exclude the investment contract business from *The Securities Act* 1955 and to bring it under an Act dealing specifically with investment certificates.

Although there have been amendments to the *ICA* during the intervening years, the relevant provisions for the purposes of this Investigation have remained basically unchanged. The following provisions of the *ICA* are particularly important.

Definition of an Investment Contract

Section 1(c) of the *ICA* defines an investment contract as follows:

> 1 In this Act,
>
> • • • • •
>
> (c) "investment contract" means a contract, agreement, certificate, instrument or writing containing an undertaking by an issuer to pay the holder thereof, or his assignee or personal representative or other person, a stated or determinable maturity value in cash or its equivalent on a fixed or determinable date and containing optional settlement, cash surrender or loan values prior to or after maturity, the consideration for which consists of payments made or to be made to the issuers in installments or periodically, or of a single sum, according to a plan fixed by the contract, whether or not the holder is or may be entitled to share in the profits or earnings of, or to receive additional credits or sums from, the issuer, but does not include a contract within the meaning of the *Insurance Act*.

An investment contract is distinguished from a security by operation of s. 49 of the *ICA*, which provides that:

> 49 Notwithstanding anything in the *Securities Act*,
>
> (a) an investment contract shall be deemed not to be a security, and
>
> (b) an issuer shall be deemed not to be an investment company within the meaning of that Act.

It was submitted in argument that many of the certificates issued by FIC and AIC did not meet the definition of an investment contract and therefore that such certificates should not have been approved under the *ICA*. I will address that point shortly.

Registration

The *ICA* provides in s. 3 that no person shall issue an investment contract unless that person is registered under the *ICA* as an issuer. An issuer is defined in s. 1(d) as a company that offers for sale, sells or enters into investment contracts of its own issue. The *ICA* also provides for the registration of salesmen, who are defined in s. 1(j) as those persons employed, appointed or autho rized by an issuer to sell investment contracts. These registrations lapse each March 31 and therefore must be renewed annually. According to s. 4, applications for registration or renewal of registration are made to the Superintendent of Insurance, in a prescribed form for a prescribed fee.

The power of the Superintendent of Insurance in considering an application for registration is provided for in s. 7 of the *ICA*, as follows:

> 7 The Superintendent may grant registration, or a renewal thereof, to a salesman or issuer if he is satisfied that the applicant is suitable and the proposed registration is not for any reason objectionable, but if the Superintendent, after investigation, is for any reason of the opinion that the applicant should not be registered, he may refuse the application.

The financial requirements for registration are stated in s. 8 of the *ICA*:

> 8 No company shall be registered under this Act as an issuer, unless
>
> • • • • •
>
> (b) the company's unimpaired paid-in capital, paid-in surplus and earned surplus, or any one or more of them, amount in the aggregate to $500 000 or a lesser amount, not being less than $250 000, that the Superintendent approves,
>
> (c) arrangements satisfactory to the Superintendent have been made for the deposit with a trust company, bank or other suitable depository or depositories within Canada of qualified assets approved by the Superintendent aggregating in amount, when valued as provided in section 29, not less at any time than the amount for which the company, under the terms of its investment contracts, is liable as of that time to pay in cash to the holders of all its investment contracts then outstanding . . ., and
>
> (d) the company maintains the reserves specified in section 30.

Section 31 of the *ICA* provides that:

> 31 A registered issuer shall not issue investment contracts for sale in Alberta unless the issuer maintains
>
> (a) the reserves specified in section 30, and
>
> (b) deposit or deposits of the assets that are specified in section 8(c).

In testimony, the requirements of s. 8(b), (c) and (d) were referred to as the "section 8 tests". The evidence shows that disputes arose between the regulators and the companies as to compliance by FIC and AIC with these tests, which will be described below. Section 31 was the subject of argument by counsel and will also be discussed below.

The rationale for the s. 8 tests was explained in a July 26, 1974 memorandum from Superintendent Darwish to the Minister of Consumer Affairs, Dowling. [Exhibit 552 at 69] With respect to the s. 8(b) test, Darwish said:

> The reason for the unimpaired capital and surplus of $500,000 is to act as a cushion and additional protection to the public when buying investment contracts. This cushion is to be available, for example, during periods of time when stock markets may decline. A decline of the market value of the security would on the face of it mean that there would not be sufficient assets to pay the investment contract holder. The $500,000 of unimpaired capital and surplus would, however provide the additional funds needed to allow the company to pay off in full their certificate liability.

He described the calculation of unimpaired capital under s. 8(b) as follows:

> There is a standard method used by insurance company, trust company and investment company administrators in the various provinces of Canada in arriving at what the unimpaired capital of the company is. This standard calculation takes the unimpaired capital and surplus shown by the company and deducts from it such assets as "deferred expenses", "leasehold improvement", "furniture and fixtures" and "salesman's advances". These assets are not allowed as proper assets to be held against unimpaired capital and surplus because they cannot be readily realized upon and furthermore should the company find itself in financial difficulties, it has been established beyond any doubt that these assets really have no value on winding-up. Thus the administrator is looking for good liquid assets. . . .
>
> Another item that is deducted by the administrators across Canada in calculating unimpaired capital and surplus are "non-admitted assets". These are investments that are made in contravention of the powers bestowed upon the company by the Act.

The Alberta regulators treated this test as the most important of the three. [28402]

With respect to the s. 8(c) test, Darwish said:

> The main thrust of the Investment Contracts Act is to ensure that companies in doing this kind of business invest in the better type of asset so as to ensure that funds will be available to re-pay the public as their certificates mature.

The "qualified assets" referred to in s. 8(c) are defined in s. 1(g) as meaning:

> 1 In this Act,
>
> • • • • •
>
> (g) "qualified assets" means
>
> (i) cash,
>
> (ii) first mortgages on improved real estate and first mortgages made under the *National Housing Act*, RSC 1952, c188 or the *National Housing Act*, RSC 1970, cN-10,
>
> (iii) bonds, debentures, stocks and other securities of the classes authorized under the *Canadian and British Insurance Companies Act* (Canada) for the investments of the funds of companies registered thereunder,
>
> (iv) real property acquired by foreclosure or in satisfaction of a debt and held for a period of less than 7 years, and
>
> (v) any other investments or securities designated by the regulations.

No other investments or securities were ever designated by regulation as qualified assets.

Section 8(c) requires that these qualified assets be valued as provided in s. 29:

> 29(1) In any statement or balance sheet to be filed with the Superintendent under this Act, an issuer may value its assets as follows:
>
> (a) cash, in the amount thereof in lawful money of Canada;
>
> (b) first mortgages, in the amount of the balance of the principal sum secured thereby together with all unpaid interest accrued thereon;
>
> (c) bonds, debentures and other evidences of indebtedness having a fixed term and rate of interest, and not in default as to principal or interest, and, in the opinion of the Superintendent, amply secured,
>
> (i) if purchased at par, at the par value, or
>
> (ii) if purchased above or below par, on the basis of the purchase price adjusted so as to bring the value to par at maturity and so as to yield meantime the effective rate of interest at which the purchase was made, but the purchase price shall in no case be taken at a higher figure than the actual market value at the time of purchase;
>
> (d) bonds, debentures and other evidences of indebtedness having a fixed term and rate of interest and in default as to principal or interest, or not amply secured in the opinion of the Superintendent, at the market value at the date of the statement;
>
> (e) stocks, at the book value not in excess of the cost to the issuer and in the aggregate not in excess of the aggregate market value at the date of the statement;
>
> (f) other securities, at the book value but not in excess of the aggregate market value at the date of the statement.
>
> (2) Notwithstanding subsection (1), if any assets consist of securities whose market values are unduly depressed and in respect of which companies registered under the *Canadian and British Insurance Companies Act* (Canada) have been authorized to use values in excess of those market values, the assets may, with the approval of the Superintendent, be valued as authorized under that Act.
>
> (3) Notwithstanding subsection (1), if it appears to the Superintendent that the amount secured by mortgage on any parcel of real estate, together with interest due and accrued thereon, is greater than the value of the parcel, or that the parcel is not sufficient for the loan and interest, he may procure an appraisement thereof, and if from the appraised value it appears that the parcel of real estate is not adequate security for the loan and interest, the loan or mortgage shall be valued at an amount not to exceed the appraised value.
>
> (4) Notwithstanding subsection (1)(b), if a mortgage has been acquired at a discount, the valuation shall be reduced by the unearned portion of the discount computed as being the proportion thereof which bears the same ratio to the total discount as the amount of the mortgage at the date of valuation bears to the amount of the mortgage at the time it was acquired by the issuer, or in lieu thereof, on any other basis that may be acceptable to the Superintendent.

The "reserves" referred to in the s. 8(d) test are designed to require the maintenance of assets sufficient to meet contract liabilities as they fall due. They are described in s. 30:

> 30 A registered issuer shall, at all times, maintain reserves for the payment of its outstand ing investment contracts that, together with

> (a) all future payments to be received by it on those investment contracts, or the portions of the future payments still to be applied to reserves, and
>
> (b) accumulations of interest at an assumed rate provided in the contracts, but not to exceed a rate approved by the Superintendent,
>
> will attain the face or maturity value specified in the contracts when due, or the amounts payable in accordance with the terms of the contracts.

This requirement was interpreted by Darwish as follows:

> I interpret this to mean that a company must maintain assets, of a type allowed under the Act, equal to the amount of the reserves for outstanding contracts. If assets were not held on this basis then a company could have assets equal to cash surrender value, but on the day the contract matured, find themselves short of assets. [Exhibit 552 at 71]

It is apparent from s. 30 that at any given time the lower the assumed reserve interest, or accumulation, rate the greater the amount of assets that must be held in reserve. For investment contracts entered into on or after November 1, 1980 maximum assumed reserve accumulation rates were approved by the Superintendent as follows:

Single pay contracts up to 5 years	7%
Single pay contracts 6 to 10 years	6%
Installment contracts up to 5 years	5.5%
Installment contracts 6 to 10 years	5%
Installment contracts 11 to 15 years	4.75%
Installment contracts over 15 years	4.75%
Extended benefits after maturity	3.5%

[Exhibit 552 at 612]

Darwish testified that these rates were patterned after those used in Ontario and were supposed to be conservative rates that could be earned. [26092-3] Pointe referred to them as rates the companies could reasonably earn on their investments. [28937-8]

Notwithstanding the maximum approved rate of 7% on single pay contracts up to five years, the evidence shows that FIC and AIC in fact used 6% with respect to such contracts.

It should be noted that since the payment of additional credits was discretionary, there was no statutory requirement to establish reserves for them until they were declared and became actual liabilities. The practice of FIC and AIC was to record additional credits as liabilities in the books once they were declared. [6223-6; 27056] Additional credits, together with the reserves, formed the "certificate liabilities and reserves" shown on the companies' financial statements, which are described below. [Exhibit 567 at 368]

Investments

Sections 34 to 36 of the *ICA* provide for the types of investments issuers are permitted. These sections provide as follows:

> 34 Subject to section 36 and to the regulations, a registered issuer may invest its funds only in investments in which a company registered under the *Canadian and British Insurance Companies Act* (Canada) may invest its funds.
>
> 35(1) No officer, director or employee of an issuer shall directly or indirectly purchase from or sell to the issuer any securities, mortgages or real property in which he has any equitable or legal interest.
>
> (2) No officer, director or employee of an issuer shall traffic or deal directly or indirectly in securities, mortgages or real property being acquired by or sold by the issuer except in the ordinary course of his duties as agent of the company.

> (3) No director, officer or employee of an issuer shall directly or indirectly have or acquire any interest in any real property in which the issuer has any equitable or legal interest.
>
> (4) Except by way of salary or other remuneration as a director, officer or employee of the issuer, no officer, director or employee of an issuer shall take or derive, directly or indirectly, any money or benefit by reason of the issuer acquiring, buying, selling or disposing of any securities, mortgages or real estate.
>
> 36(1) A registered issuer may acquire and hold for its own use and benefit any real property that is necessary for the transaction of its business and may acquire or hold or construct a building larger than is required for the transaction of its business, and may lease any part of the building not so required.
>
> (2) A registered issuer may acquire and hold any real property that is bona fide mort gaged to it by way of security, and any real property acquired for it by foreclosure or in satisfaction of a debt, and may sell, mortgage, lease or otherwise dispose of that real property, but an issuer shall sell any real property acquired by foreclosure or in satisfaction of a debt, within 7 years after it has been so acquired.

Section 52 [formerly s.33] of the *CBICA* prohibits, *inter alia*, a company from knowingly investing in corporations which have a substantial shareholding in the company or in corporations in which a director, officer or substantial shareholder of the company has a significant interest. Other sections of the *CBICA*, referred to elsewhere in the Report, outline the types of investments in which a company may invest its funds.

Disputes arose between the regulators and the companies as to whether s. 52 of the *CBICA* applied to investment contract companies and whether certain of the assets held by FIC and AIC, in particular shareholdings in related corporations, qualified under the provisions of the *ICA* and the *CBICA*. These matters will be addressed below.

Filing of Financial Statements

The *ICA* provides as follows:

> 26(1) A registered issuer shall file with the Superintendent a quarterly or monthly financial statement on the dates required by the Superintendent.
>
> (2) The statement shall be in a form and shall be certified in a manner approved by the Superintendent, showing
>
> > (a) the amount, on the last day of the quarterly or monthly period, required by section 30 to be maintained as reserves by the issuer on all outstanding investment contracts,
> >
> > (b) all qualified assets on deposit, on the last day of the specified period last ended, with the trust company, bank or other depository or depositories within Canada approved by the Superintendent, and the value, when valued as provided in section 29, of the qualified assets as at that date, and
> >
> > (c) any other information that the Superintendent requires.
>
> 27(1) Not later than 90 days after the expiration of its fiscal year, a registered issuer shall file with the Superintendent a balance sheet and profit and loss statement for that completed fiscal year, certified by 2 of its directors and reported on by its auditor, in a form approved by the Superintendent, and any other financial statements the Superintendent requires.
>
> (2) The market value of all securities at the date of the statement shall be noted on the balance sheet.

Two types of audited financial statements were filed annually with the Superintendent; the financial statements prepared in accordance with GAAP [Exhibits 272 and 273] and the so-called "regulatory statements" (Statements of Assets, Certificate Liabilities and Reserves, and Other Liabilities) prepared in accordance with the reporting requirements of the *ICA*. [Exhibits 296 and 297]

The difference between the two types of financial statements was explained by Eldridge, a member of the Audit Section within CCA, as follows:

> Our examinations in the past have been based primarily on the Statement of Assets rather than the audited Balance Sheet. Due to the nature of the legislation there are differences between the aforementioned two financial statements. Some of these differences are:
>
> 1. When stocks have a market value less than cost they are shown at market value on the Statement of Assets etc. This was the situation as at December 31, 1983.
> 2. Certain deferred expenses which are not eligible assets are offset to certificate liabilities on the Balance Sheet.
> 3. Bonds in default are valued at market.
>
> The following financial requirements of the Act are not covered in the audited balance sheet or financial statements.
>
> 1. Calculation of Unimpaired Capital as per Section 8(b) of the Act.
> 2. Calculation of Assets required to be held as Reserves per Sections 8(d) and 30 of the Act.
> 3. Calculation of Qualified Assets on Deposit to Cash Surrender Value of Certificates as per Section 8(c) of the Act.
>
> These items are included in the Statement of Assets.
>
> Before we can examine the preceding calculations they must be reported upon by the companies' auditors.
>
> To summarize, the Statement of Assets is looked upon by the audit section as similar to the Balance Sheet in the Annual Statement of an insurance company and is thus an important statement prepared according to the requirements of the Act. [Exhibit 567 at 647-8]

Historically, FIC and AIC also filed quarterly audited statements. In or about 1978 the Superintendent agreed that the companies could instead provide monthly financial reports, including a Statement of Assets, Certificate Liabilities and Reserves and Other Liabilities. [28443-4] The monthly statements were almost invariably late. [27898-9] In late 1984, as a result of dissatisfaction with the monthly reports, the companies were asked to again provide quarterly audited statements. That was never done and the matter was not pursued by the Superintendent. [27207; 27901-2]

Inspection of the Books

The *ICA* provides as follows:

> 32(1) The Superintendent or a person to whom as his representative he, in writing, delegates authority may at any time make or have made an inspection of the books, documents and records of any issuer and of any salesman.
>
> (2) On the inspection, the Superintendent or his authorized representative is entitled to free access to all books of account, cash, securities, documents, bank accounts, vouchers, correspondence and records of every description of the issuer or salesman, and no person shall withhold or destroy, cancel or refuse to furnish any information or thing reasonably required by the Superintendent for the purposes of the inspection.
>
> (3) The Superintendent may charge any fees he considers proper for any inspection made under this section.

Pursuant to this section, examinations of FIC and AIC were done on a regular basis.

Approval of Investment Contract Forms and Promotional Materials

The *ICA* provides as follows:

> 24(1) A copy in duplicate of each form of investment contract to be issued by the issuer for sale in Alberta shall be filed with the Superintendent.
>
> (2) No form of investment contract shall be used unless it has been accepted for filing by the Superintendent and one copy thereof has been returned to the issuer bearing written evidence thereon that it has been accepted by the Superintendent for filing.
>
> 25(1) No circular, pamphlet, brochure, specimen contract, application form or other document to be used by an issuer or a salesman in connection with the sale of any investment contract shall be used by an issuer or salesman until it has first been submitted to and approved in writing by the Superintendent.
>
> (2) The Superintendent may at any time require any issuer or salesman to submit for review any circulars, pamphlets, brochures, specimen contracts, application forms or other documents used by the issuer or salesman in connection with the sale of investment contracts.
>
> 46 No person or company shall make representation, written or oral, that the Commission or the Superintendent has in any way passed on the financial standing or solvency of any issuer registered under this Act or on the merit of any investment contract.

The conduct of the Superintendent's office in carrying out this approval process is reviewed below.

Power to Enforce Compliance

The *ICA* provides as follows:

> 10(1) The Superintendent may suspend or cancel any registration on any grounds that would justify refusal to grant registration or renewal of registration.
>
> (2) The Superintendent may refuse, suspend or cancel the registration of an issuer when it appears to him from the statements and reports filed with him or from an investigation, inspection or valuation that the issuer will be unable to provide for the payment of its investment contracts at maturity.
>
> 37 The Superintendent may make a special report to the Minister with respect to any registered issuer when the Superintendent is satisfied, on the basis of an examination and inspection of that issuer's affairs or on the basis of any other source of information available to him, that
>
> > (a) the issuer has defaulted on the payment of any of its liabilities,
> >
> > (b) the issuer is not complying with this Act or the regulations and that the failure or the continuance of the failure to so comply is or may be prejudicial to the interests of the issuer's investment contract holders or creditors,
> >
> > (c) the issuer's unimpaired paid-in capital, paid-in surplus and earned surplus, or any one or more of them, does not amount in the aggregate to $500 000 or any lesser amount the Superintendent has approved under section 8(b),
> >
> > (d) there exists any state of affairs within the issuer of a serious nature that is or may be prejudicial to the interests of the issuer's investment contract holders or creditors,
> >
> > (e) the issuer has failed to maintain the deposit of qualified assets as set out in section 8(c),
> >
> > (f) the issuer has failed to maintain adequate reserves as set out in section 30, or
> >
> > (g) the issuer has ceased to carry on business in Alberta.

38 When the Superintendent makes a special report to the Minister and recommends the appointment of a receiver and manager, the Minister may recommend to the Lieutenant Governor in Council that a receiver and manager be appointed

(a) for the issuer if the issuer was incorporated in Alberta, or

(b) for the issuer's branch offices, assets and affairs within Alberta if the issuer was incorporated elsewhere than in Alberta,

and the Lieutenant Governor in Council may make an order accordingly.

40(1) The Lieutenant Governor in Council may make an order that an issuer be wound up and appointing a liquidator for the issuer

• • • • •

(b) when the Superintendent makes a special report to the Minister and recommends that the order be made and the Minister also recommends that the order be made. . . .

The responsibility of the Superintendent and others to enforce compliance with the *ICA* was the subject of much argument and is addressed below.

Applicability of *ICA*

It was submitted in argument by counsel for Marlin that the single pay term certificates sold by FIC and AIC did not satisfy the definition of an "investment contract" in the *ICA* in that they did not have optional settlement provisions, cash surrender or loan values and therefore I ought not to review the business or affairs of FIC and AIC in the context of the requirements of the *ICA*. Counsel on behalf of the Investors argued that most, if not all, of the single pay or term certificates were not within the definition of "investment contract" and ought to have been regulated by the ASC pursuant to the *Securities Act*.

The question of whether single pay certificates were investment contracts was raised by Donald Cormie in a letter to Attorney General Manning dated September 16, 1966. [Exhibit 473] Therein he distinguished between two types of business being carried on by FIC; the "installment certificate" business which competed with the life insurance industry and the "guaranteed investment certificate" business which competed directly with trust companies and banks. It occurred to him that guaranteed investment certificates, not containing optional settlement, cash surrender or loan value prior to or after maturity provisions were not "investment contracts" and he asked for comments in that regard. He could not recall receiving a response [20252-5] and there is no evidence that the question was considered by the regulators at that time.

It is clear that Marlin was also aware that single pay certificates did not conform to the definition of an investment contract. He testified:

Q To your knowledge, Mr. Marlin, does the term certificate have a cash surrender value?

A The term certificate does not have a cash surrender value.

Q When we say "term certificate", we mean a single pay certificate, right?

A The present certificate being issued does not have a cash surrender value.

Q Does it have an optional settlement provision?

A No, it does not.

Q Do you consider it to have a contractual loan value?

A No, there's no provision for a loan in the terms of the contract.

Q Did the Superintendent's office approve of the form of contracts you're using even though you felt it didn't have these three provisions in it?

A Yes, they accepted that it was an investment contract and was administered under the Investment Contracts Act. [12633-4]

Marlin testified that every year he expected the *ICA* would be amended to, *inter alia*, "make it more appropriate to the type of certificates being issued on the current basis", that being single pay certificates. [11881-2]

The Attorney General's office advised Eldridge in a memorandum dated November 10, 1981 that single pay certificates did not contain a cash surrender or loan value or optional settlement figure and therefore did not meet the requirements of the *ICA*. [Exhibit 559 at 2] Copies of the memorandum were given by Eldridge to Pointe, then Director of Audits, and Kaiser, then Superintendent of Insurance [Exhibit 567 at 365; Exhibit 559 at 1] and Eldridge noted in his covering memorandum to Kaiser that "the majority of the certificates issued by First and Associated do not have a cash surrender value". Eldridge made a similar notation in his 1981 annual examination reports. [Exhibit 550 at 44; Exhibit 551 at 57] Pointe advised Eldridge that this matter should be "fully discussed" with Kaiser. [Exhibit 567 at 397; 28517-9] Eldridge testified that it did not occur to him at the time and he did not discuss with Superintendent Kaiser whether single pay certificates should be regulated under the *Securities Act*. [27453] He also testified that he did not discuss with Superintendent Saleh the implications of single pay certificates not being investment contracts [27637] and said it did not occur to him at the time that they might have fallen under the *Securities Act*. [27453] Pointe's evidence was that it was never discussed internally within the office of the Superintendent that they lacked authority to regulate these certificates and the companies never challenged the authority of the Superintendent to do so. [28514-7]

The matter arose again in 1983 and 1984 during reviews of the "Principal Plus Plan" and the contract application form, respectively by the regulators. In both instances, FIC and AIC were told that a statement had to be included indicating the cash surrender or loan value of the contract. [Exhibit 567 at 480; Exhibit 576 at 615] In response, the companies set up an "automatic loan privilege" whereby they would lend money against the certificates, although this was not a term of the certificates themselves. [Exhibit 567 at 484; 12634; 13505-6]

Eldridge testified that he could not recall any discussion with Saleh at that time about the matter or the implications of single pay certificates not being investment contracts. [27453-4; 27637] Saleh could not recall any such discussion. [29607-8; 29984]

It is clear that both the companies and the regulators were aware that single pay certificates did not conform to the definition of an investment contract. I agree.

However, the companies requested approval for the sale of such certificates under the *ICA*, requested approval of contract application forms which stated that FIC and AIC were registered under the *ICA* and that pursuant to the *ICA* had or were required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank, and submitted to regulation under the *ICA*.

The regulators, acting under the *ICA*, approved the sale of single pay certificates, in my view without authority. The regulators, under the approval authority of s. 24 of the *ICA*, approved and accepted for filing the contract application forms with the representations stated therein, and had a duty to regulate these certificates pursuant to the *ICA*.

I will deal with the purported regulation of such certificates hereafter but, as a consequence of the approval of the sale of single pay certificates under the *ICA*, they were never subject to the type of capital base and capital ratio requirements imposed on trust companies and banks offering guaranteed investment certificates (GICs) for sale to the public. It is clear to me that the capital requirements of the *ICA* were not intended, and were inadequate, to regulate the sale of single pay certificates. No doubt that is why the definition of investment contracts in the *ICA* does not include such certificates.

I have come to the conclusion that the evidence tends to show that regulatory permission to sell and the sale of single pay certificates without adequate safeguards was one of the major reasons for the demise of FIC and AIC.

I turn now to the regulation of FIC and AIC under the *ICA*.

C. THE REGULATORY STRUCTURE

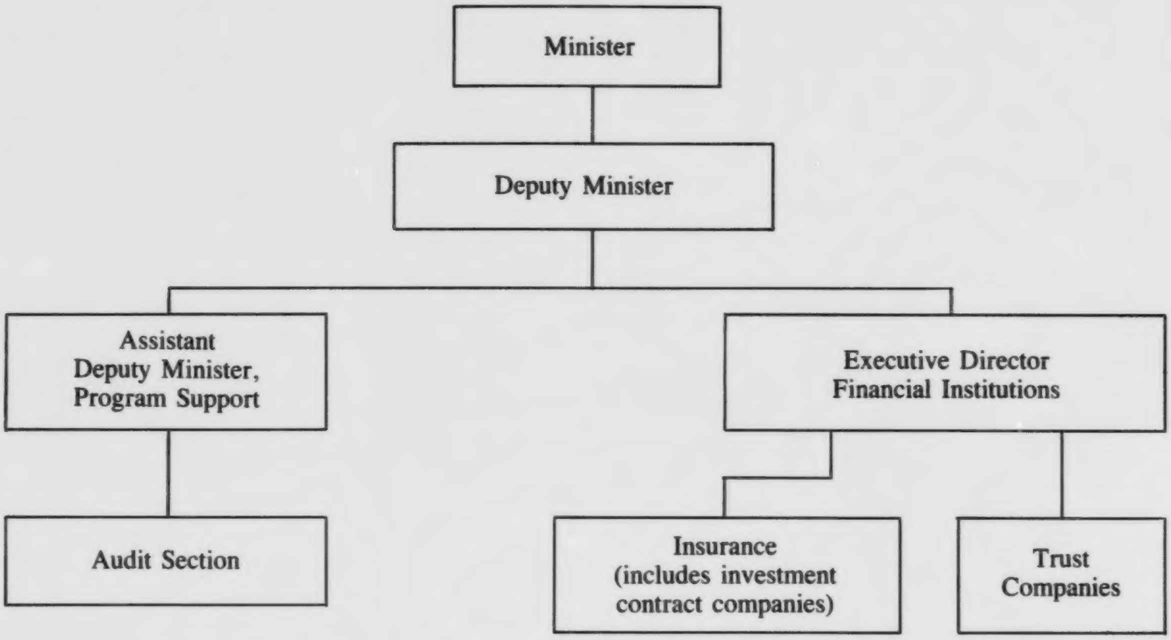
Department of Consumer and Corporate Affairs

Under the original *ICA*, S.A. 1957, c. 36 regulatory authority over investment contract companies was vested in the ASC. By amendment, S.A. 1973, c.32, this authority was transferred to the Superintendent of Insurance.

The Superintendent of Insurance is appointed under the *Insurance Act*, R.S.A. 1980, c. I-5, as amended, and the office is part of CCA. The organization of CCA is shown in Exhibit 546 and in Exhibit 567 at 8. Prior to May of 1981, the position was titled Superintendent of Insurance and Real Estate and reported to the Deputy Minister. In May of 1981, there was a major reorganization and CCA was divided into 3 functional divisions: program development, program support and regional delivery. Each was headed by an Assistant Deputy Minister. The position of Superintendent of Insurance and Real Estate was split and the position of Superintendent of Insurance created. The Superintendent of Insurance reported to the Executive Director, Program Development who reported to the Assistant Deputy Minister, Program Development who in turn reported to the Deputy Minister, CCA.

Another reorganization took place in October of 1983. As a result, the Superintendent of Insurance reported to the Executive Director, Financial Institutions, who was responsible for credit unions, trust companies, insurance companies and investment contract companies. The consolidation of responsibility for financial institutions was prompted by the financial difficulties they were encountering and a desire to take closer control of those areas. The Executive Director reported directly to the Deputy Minister who, of course, reported to the Minister. [Exhibit 580 at 66] Ultimately, and in accordance with s. 1(e) of the *ICA*, the Minister of CCA was charged by Cabinet with administration of the *ICA*.

In the result, as at late 1983 the relevant reporting hierarchy within CCA was as follows:


Minister
Deputy Minister
Assistant Deputy Minister, Program Support
Executive Director Financial Institutions
Audit Section
Insurance (includes investment contract companies)
Trust Companies

The following individuals held the Minister's portfolio:

Robert Dowling	March 1973 — April 1975
Graham Harle	April 1975 — March 1979
Julian Koziak	March 1979 — November 1982
Constantine Osterman	November 1982 — February 1986
Al (Boomer) Adair	February — May 1986
Elaine McCoy	May 1986 through June 30, 1987

[Exhibit 547]

Barry Martin was the Deputy Minister from January, 1979 to February, 1987. He described his responsibilities as being two-fold: (1) administration, including budget, staff and supervision of programs and legislation administered by CCA; (2) interpreting the aspirations of the Minister and developing programs to meet them. [30112-3]

James Darwish held the position of Superintendent from 1972 to March of 1981. In September of 1981, Ronald Kaiser became Superintendent. He held the position until March of 1983, when Tewfik Saleh became Acting Superintendent. As part of the 1983 reorganization, Saleh was named both Superintendent and Executive Director, Financial Institutions. [Exhibit 547]

Within CCA was a small group of chartered accountants described as "auditors" and most often referred to in testimony as the "Audit Section". This group included, at various times, Reg Pointe, Burt Eldridge, Nick Romalo, Al Hutchison, Pat Visman, Alvin Cheung and Doug Higgins. From 1973 until the reorganization of CCA in 1981 the Audit Section, which was headed by a Deputy Superintendent — Audits, reported to the Superintendent of Insurance. As a result of the 1981 reorganization, the Audit Section became part of the program support area under a Director of Audits and reported to the Assistant Deputy Minister, Program Support. That continued after the 1983 re organization. Accordingly, the Assistant Deputy Minister, Program Support was responsible for the administration of the Audit Section, although it provided services to the Superintendent of Insurance at his request and pursuant to s. 32 of the *ICA*.

The Audit Section reviewed the monthly and annual financial statements filed with the Superintendent of Insurance by FIC and AIC. It was also privy to the correspondence between the companies and the Superintendent. The financial information was analyzed and significant changes noted and followed up with FIC and AIC. [26160-1] The results of these "desk examinations" were recorded in the form of memoranda which were forwarded from the Director of Audits or senior auditor to the Superintendent for his information and action.

In addition to the desk examinations, the Audit Section carried out annual "field examinations" at the offices of FIC and AIC. According to Pointe, the annual field examinations were preceded by a review of both the audited GAAP and regulatory statements. These would normally be received in February, March or April, and in some years (1984 and 1986) as late as May. A desk examination would be done, following which the field examination would commence. [28409] During the course of the desk examination, the auditors would look for qualifications to the financial statements, read the notes to the statements for indications of problems and generally check the figures to see if they accorded with the auditors' knowledge from earlier examinations. [25523] The field examinations themselves would usually take one month and involve a team of 3 auditors. [26162] They were done using an audit program, which was basically a checklist of procedures necessary to permit evaluation of the assets and liabilities in accordance with the *ICA*. [26170-1; Exhibit 562 at 6] The field examinations would conclude with "exit interviews" with the chief financial officer of the companies at which further information or clarification was obtained by the auditors and any major concerns reviewed. [26221-2]

The annual examination was not an "audit" as that term is used in relation to the external auditors. According to Eldridge and Romalo, the Audit Section did not do all of the things an external auditor would do. [27600-2; 26891-2] The purpose of the examinations was to determine whether FIC and AIC were in compliance with the *ICA*, and in particular the s. 8 tests, to ensure that they had sufficient assets to meet their liabilities to contract holders. [25305; 26008; 28402; 26342]

While the auditors would examine the audited financial statements and management letters during the annual examinations and note any concerns of the external auditors expressed therein, the Audit Section did not work with or normally deal directly with the external auditors. [26427-34; 26212-3]

The findings of the annual examinations were documented in reports which were prepared each year and delivered to the Superintendent. [28414; 26944] The annual examination reports on FIC and AIC for the years 1978 through 1985 were tendered in evidence as Exhibits 550 and 551 respectively. These reports were not normally sent to the Deputy Minister or Minister. [25702; 29099; 30119; 30940-1] It was the responsibility of the Superintendent to convey the findings "up the line". Martin's evidence was that the Superintendent would summarize the reports and the main elements of the examinations for him, but would not go into the detailed numbers. [30119]

The annual examinations were done after receipt of the year-end audited financial statements, and therefore the Superintendent did not have the reports in hand each March 31 when the licences came up for renewal. He usually received the annual examination reports in July or later.

The annual field examination reports were not provided to FIC and AIC. Rather, the practice developed whereby the Superintendent would send "compliance letters" to the companies notifying them of concerns and problems arising out of the examinations. Almost invariably FIC and AIC would take issue with the matters raised, and the concerns and problems would then be the subject of further correspondence and meetings between the regulators and the companies. [26255]

It was not the practice of CCA to provide copies of either the annual examination reports or correspondence with the companies to the external auditors. [25724; 27395-6] Nor was it the practice of CCA to provide copies of the annual examination reports or convey the findings to the regulators in other provinces where FIC and AIC certificates were sold. [25338-9; 28831-2; 34655]

Alberta Treasury

By Order-in-Council dated June 11, 1986 [Exhibit 587 at 16], administration of the *ICA* was transferred from the Minister, CCA to the Provincial Treasurer. That portfolio was (and is still) held by Archibald (Dick) Johnston. The *ICA* was not amended to reflect the transfer and the Superintendent of Insurance remained the person designated as having regulatory authority over the sale of investment contracts through June 30, 1987. From the time of the transfer, actual authority was exercised not by CCA but by Treasury. Al Kalke, the Assistant Deputy Treasurer, Revenue was responsible for the day-to-day regulation of FIC and AIC. He reported to Allister McPherson, the Deputy Provincial Treasurer, who in turn reported to Johnston. On January 7, 1987 Kalke was appointed Acting Superintendent of Insurance to enable him to engage Price Waterhouse Limited to carry out an inspection of FIC and AIC pursuant to s. 32 of the *ICA*. [31758-9]

At the time of the transfer of jurisdiction to Treasury, 3 of the auditors from the Audit Section (Romalo, Visman and Higgins) were transferred from CCA to Treasury and put under the direction of the Director of Trust Companies (Pointe), who was also reassigned from CCA to Treasury. [28412-4]

D. REGULATION OF FIC AND AIC IN THE 1970s

Although the focus of my Investigation is on the period from 1980 to June 30, 1987 it is helpful to briefly review the regulation of FIC and AIC in the 1970s, because many of the issues and problems that arose in the 1980s were foreshadowed in the 1970s.

According to Darwish, who worked as an auditor for the ASC for most of the period 1959-1972, the ASC developed the practice of inspections or examinations of investment contract companies and acquired the staff necessary to carry out such examinations. [25288] The purpose of such examinations was to determine whether the companies were in compliance with the financial requirements of the *ICA*.

The procedure developed by the ASC was described in a Special Report on AIC dated April 26, 1973 and prepared by G.H. Rose and N.V. Buchanan, chairman and vice-chairman respectively of the ASC. The Special Report was made to Attorney General Leitch [Exhibit 557 at 102] and stated in part at 106:

> The Commission receives financial reports from all investment contracts companies on a quarterly and an annual basis. On receipt of each return the Commission's Auditors review the Company's financial position, in the light of what has been reported. It is not, however, until the annual, audited financial statements have been received, that the full picture can be ascertained. In view of this, the Commission's Auditors from time to time, do a review of the Company's investments and assets, to satisfy themselves that the Company is being operated without undue risk to the public.

It was such a review that prompted the Special Report, which reported that AIC failed to meet the requirements of s. 8(b) and (c) of the *ICA* and recommended, with some qualification, the appointment of a receiver and manager. [Exhibit 557 at 109]

The Special Report stated that AIC had "been operating on the borderline" with respect to its capital and qualified assets on deposit since its acquisition by Donald Cormie and that FIC had also "given rise to frequent problems, but not to as great an extent". It listed a number of "perennial problems" which had been faced over the years with respect to FIC and AIC, as follows:

1) Deficiencies in unimpaired capital and surplus;

2) Deficiencies in qualified assets on deposit;

3) Disputes as to whether assets were qualified;

4) Investments, usually involving related company transactions, which the ASC believed were illegal;

5) Protracted argument as to the meaning of sections of the *ICA*;

6) Inadequacy of the *ICA* in setting out the rights and obligations of issuers registered thereunder;

7) "Legalistic" approach by Donald Cormie to compliance with the *ICA*. [Exhibit 557 at 103]

Shortly thereafter, administration of the *ICA* was transferred from the ASC to CCA and the Superintendent of Insurance, James Darwish. Darwish testified that at that time Rose told him he was concerned about the financial standing of FIC and AIC. [25295-6] Darwish and Rose prepared a joint memorandum dated July 19, 1973 to the Attorney General advising that FIC and AIC were, according to their latest financial statements, respectively borderline and deficient in their capital requirements and recommending that the Government retain outside firms of chartered accountants and lawyers "to conduct a thorough examination" of the financial affairs of CSL, PGL, FIC, AIC and PS&T. [Exhibit 557 at 115]

Darwish testified that a practice of engaging independent consultants had been established by the ASC in instances when there were major problems with the companies, criticism of the auditors' work or differences of opinion between the regulators and the companies. [25623-4]

As a result of the joint memorandum and subsequent meetings among Attorney General Leitch, Minister of CCA Dowling and Donald Cormie, Ernst & Ernst and Robert Black, Q.C. were retained by the Government to conduct an examination of AIC to enable them to report on its financial position and express an opinion on whether it was operating in accordance with the *ICA*. Upon receipt of the report, the Government was to decide what, if any, similar reports it ought to have with respect to other companies in the Principal Group. [Exhibit 552 at 67]

Ultimately two reports were prepared, the first dated July 31, 1974 with respect to AIC and the second dated December 4, 1974 with respect to FIC. [Exhibit 553 at 1; Exhibit 552 at 2] These reports indicated deficiencies in qualified assets of approximately $1.1 million for AIC and $2.2 million for FIC. Ernst & Ernst outlined certain steps which FIC and AIC would have to take to meet all certificate liabilities at their maturity dates and stated that in the interim they may need an injection of capital sufficient to cover the deficiencies in qualified assets and provide an equity cushion of unimpaired capital.

Upon receipt of the Ernst & Ernst report on AIC, Darwish sent a memorandum to the Minister recommending that upon receipt of the report on FIC, Donald Cormie be asked to inject sufficient assets into FIC and AIC to meet the requirements outlined by Ernst & Ernst within 120 days, failing which a receiver and manager be appointed under the *ICA*. [Exhibit 552 at 81]

According to Darwish, the Deputy Minister, Jack Lyndon, wanted a further independent review before a decision was taken. Shortreed and Gardner, respectively a lawyer and an accountant, were engaged to review the Ernst & Ernst reports and report upon the affairs of FIC and AIC. [25321] In December of 1974 two reports were prepared. [Exhibit 552 at 94; Exhibit 552 at 120] Shortreed and Gardner concluded that FIC and AIC failed to meet all three s. 8 tests. They were also concerned that the companies had deliberately invested in assets which were neither qualified nor permitted and that certain intercorporate transactions were potentially prejudicial to the investment contract holders. Shortreed and Gardner made a number of recommendations for action and suggested a timetable for compliance by the companies.

Darwish testified that on the basis of the Ernst & Ernst and Shortreed and Gardner reports, he knew that FIC and AIC did not satisfy the s. 8 tests. He issued licences to them, however, because he and the consultants believed there was no jeopardy to contract holders. Darwish stated that he felt comfortable with the decision because the Deputy Minister and Minister knew about the situation. [25993-8]

Darwish testified that he did, however, feel compelled to make Special Reports to the Minister pursuant to the *ICA*, which he did on March 27, 1975. [25316-7; Exhibit 552 at 152 and 160] These Special Reports summarized the conclusions and recommendations of Shortreed and Gardner, together with Darwish's comments.

After discussions with the new Minister of CCA, Graham Harle, and Lyndon, Darwish wrote to FIC and AIC on May 12, 1975 setting out directions and a timetable to remedy the deficiencies and concerns reported by Ernst & Ernst and Shortreed and Gardner. [25319-20; Exhibit 552 at 191 and 186] The letters were addressed to Marlin and copied to Donald Cormie. The conditions included the following:

1) With respect to AIC, elimination of the deficiency in unimpaired capital within 6 months;
2) Introduction of capital in the future to be by way of permanent share capital; any capital introduced other than by cash to be acceptable to the Superintendent;
3) Rectification of the deficiencies in qualified assets to cash surrender value of certificates and assets held against reserves within 2 years;
4) Provision of monthly financial reports to the Superintendent;
5) Written consent of the Superintendent for all intercompany transactions;
6) Review of the total costs of administration by a consultant to be appointed by the Superintendent to determine a fair return for services rendered;
7) Limits in the size and number of all large loans and investments;
8) Adherence to the requirements of s. 34 of the *ICA* with respect to investments.

The May 12, 1975 letters stated that failure to comply with any of the conditions would force Darwish to consider suspension or cancellation of the companies' registration or the making of a Special Report recommending the appointment of a receiver and manager. The letters further advised that once all deficiencies had been remedied, the conditions would be reviewed and those considered no longer necessary lifted. Darwish testified that FIC and AIC complied with the conditions, at least in 1978 and 1979. [25398-9] Pointe testified that FIC and AIC agreed to abide by the conditions contained in the May 12, 1975 letters. [28439-41] Significantly, they agreed to adhere to conditions #5 and #8; that was confirmed in subsequent letters to Darwish dated May 30 and June 4, 1975. Donald Cormie was copied on the May 30 letter while Marlin signed the June 4 letter. [Exhibit 552 at 206-14]

There is no evidence tending to show that compliance with the conditions set out in the letters was ever waived or lifted by the regulators. As set out below, FIC and AIC did not, in fact, abide by most of these conditions.

In October of 1975, Clarkson Gordon was engaged by CCA to determine, *inter alia*, the appropriateness of administration, management and distribution fees and other charges paid by FIC and AIC to PGL. [Exhibit 552 at 286 and 296] Upon receipt of the Clarkson Gordon report on fees, Darwish wrote to Marlin and Donald Cormie summarizing the main conclusions of the report and advising that all intercompany charges should bear some "logical relationship" to the related expenses. He wanted FIC and PGL to propose a more reasonable basis for charging intercompany management and administration fees covering the services provided by PGL and PCL, which proposal he would be pleased to discuss with them. [Exhibit 482 at 278] It would appear that nothing came of this. The regulators took no other action with respect to changing the basis of the intercompany charges.

At a meeting on July 21, 1978 Darwish asked that FIC maintain a capital ratio of 25:1, which Marlin said he would discuss with Donald Cormie. [Exhibit 552 at 499] The request for a capital ratio was prompted by the change in the type of certificates being sold by FIC and AIC from accumulation to single pay, and the growth of the companies. As a result of this shift and increasing sales of certificates by FIC and AIC, the Superintendent believed the *ICA* required amendment to provide for a capital ratio. [28446-8] Darwish had advised the Minister in a memorandum dated July 26, 1974 that the capital requirements of the *ICA* were inadequate. [Exhibit 552 at 69] That view was also expressed by Ernst & Ernst and Shortreed and Gardner based on their reviews of FIC and AIC, and both Ernst & Ernst and Shortreed and Gardner recommended a number of changes to the *ICA*.

In the summer of 1975, Harle had brought forward proposed amendments to the *ICA*, based on a draft uniform act prepared by the regulators of investment contract companies in Alberta, British Columbia, Saskatchewan, Manitoba and Ontario. [Exhibit 554 at 29] The proposed amendments and the situation they were intended to address are reproduced in full, as many of the perceived deficiencies in the *ICA* were the subject of comment again in the 1980s:

> **Existing Situation**
>
> 1. The assets that an Investment Contract Company may invest in are regulated by way of reference to the Canadian and British Insurance Companies Act.
> 2. The present Act does not restrict investments made in companies controlled by officers or shareholders.
> 3. There is no provision for a ratio between net equity and liabilities to the public.
> 4. There is presently a requirement for the holding of certain assets by a trustee equal to the cash surrender value of the investment contracts.
> 5. There is no provision in the Act to issue a conditional licence.
> 6. There is no restriction on the payments of dividends to shareholders of Investment Contract Companies.
> 7. There is no provision for an interim measure whereby the Superintendent may take control of the assets of an Investment Contract Company for rehabilitation purposes (although the Superintendent may appoint a receiver to wind up the company's affairs).
> 8. There is no right of rescission from an investment contract.
>
> **Proposed Changes**
>
> 1. The new Act will set out what investment can be made without reference to another Act.
> 2. Non-arms length transactions with companies in which directors, officers, or shareholders have a material interest will not be allowed.
> 3. A ratio will be required so that as the liabilities to the public increase, the net equity of the company must also increase so as to ensure at all times an adequate cushion of protection for investment contract holders. The proposed ratio is 20:1.
> 4. The deposit requirement will be eliminated as it is no longer considered to be meaningful.
> 5. Provision will be made for the issuing of conditional licences.
> 6. No dividend [sic] can be paid to shareholders until additional credits to investment contract holders have been paid. Also, dividend [sic] shall not be paid while capital is impaired, that would impair the capital, or that would reduce the capital below the ratio required.

7. There will be a section which will allow the Superintendent, upon order by the Lieutenant Governor in Council, to take control of assets for rehabilitation purposes if necessary. Such an order may be appealed to the Courts.
8. There will be a thirty-day right of rescission. [Exhibit 554 at 33]

These amendments were later withdrawn by Harle on the basis that it was not appropriate to proceed at that time. [Exhibit 554 at 125] Donald Cormie wrote to Premier Lougheed expressing concern over the proposed amendments. [Exhibit 554 at 118] The evidence does not tend to show and I make no finding as to why the amendments were withdrawn or what, if any, impact Donald Cormie's letter had on that decision.

Darwish testified that subsequent to the July 21, 1978 meeting, he and Marlin reached a "gentlemen's agreement" whereby FIC and AIC would maintain a 25:1 ratio of unimpaired capital to liabilities. [25326] He confirmed this by letter dated October 10, 1978 wherein he expressly asked Marlin to advise if his understanding was incorrect. [Exhibit 552 at 522] There is no evidence of any response by the companies or challenge to Darwish's understanding at the time, although later they complained about the imposition of such a ratio.

For example, on September 3, 1980 Marlin wrote to CCA Minister Koziak complaining that FIC and AIC were being asked to adhere to a 25:1 ratio when they already had to meet the requirements of s. 8(c) and (d) of the *ICA*. [Exhibit 478 at 109] Further, in letters dated December 12, 1980 sent to Pointe in response to his compliance letters following the 1979 annual examinations, the companies advised that they did not agree with the requirement of a 25:1 ratio but in any event met or came close to it. [Exhibit 398 at 39-44] Pointe replied that the companies' advice had been noted. [Exhibit 398 at 45-6]

Marlin denied any agreement to maintain a capital ratio. He testified that he was agreeable to a capital ratio provided that the companies could reserve "flat", that is at the fixed rate stated on the face of the contract rather than at the rate approved by the Superintendent. According to Marlin, the proviso was not accepted by the regulators. [11815-7; 12900-1]

Notwithstanding Marlin's evidence, in October of 1983 he made a videotape entitled "Depositor's Protection" which, together with an accompanying grid chart, was distributed to the sales force. Therein he represented that the requirement of a capital ratio was a protective feature of FIC and AIC. [Exhibit 392]

The evidence tends to show that Marlin, on behalf of FIC and AIC, did agree to adhere to a 25:1 capital ratio. The evidence also tends to show that the companies ignored the agreement and failed to adhere to the ratio. The Superintendent was unable to enforce compliance with the ratio as it was not a requirement of the *ICA*. The only options available to the Superintendent under the *ICA* involved suspension or cancellation of or refusal to renew their licences or the making of a Special Report to the Minister, none of which were exercised. This inaction will be discussed below.

Darwish also testified that an agreement was reached with FIC and AIC whereby they would comply with the mortgage guidelines of the federal Department of Insurance. [25404] By letter dated November 3, 1978 Darwish sent the guidelines to Marlin. [Exhibit 552 at 524] In follow-up letters to Marlin on October 15, 1979 and May 6, 1980 [Exhibit 398 at 15 and 25] Pointe confirmed that CCA would apply the guidelines to FIC and AIC, although the companies objected. [Exhibit 571 at 294 and 298]

Marlin's evidence was that the companies never agreed to adhere to these mortgage guidelines, which he said were more applicable to trust companies than investment contract companies. He stated that he was of the view that mortgage guidelines should be tied to the total asset base of the companies. [12898-900]

It is not clear to me from the evidence whether FIC and AIC actually agreed to adhere to these mortgage guidelines, although it is clear that CCA intended to apply them. As with the capital ratio, however, in the absence of a statutory requirement the Superintendent was unable to enforce compliance with the guidelines. The evidence tends to show that FIC and AIC did not follow these mortgage guidelines.

The financial condition of FIC and AIC improved during the last half of the 1970s. Darwish attributed the improvement in part to changes in the way FIC and AIC were operated as a result of the Shortreed and Gardner reports. [25630-1] At the same time, however, Eldridge noted in his 1977 annual examination report on FIC that the company had incurred an operating loss in each of the last 6 years. He attributed this to "excessive" administration and selling fees. [Exhibit 567 at 218]

Eldridge's 1977 report was forwarded by Pointe to Darwish with a covering memorandum wherein he noted a trend as follows:

> On December 31, 1971, First's percentages were accumulation 69% and single pay 31%. These percentages have changed over the next 6 years to accumulation 51% and single pay 49% as at December 31, 1977. A further decline in accumulation plans of 2½% has accrued to May 31, 1978.
>
> Consequently the liabilities of First are being concentrated in single pay plans, similar to a trust company versus accumulation plans which have features similar to insurance policies. [Exhibit 552 at 507]

Eldridge, together with Hutchison, carried out the 1979 annual examinations in the summer of 1980. In his report on FIC [Exhibit 550 at 1], Eldridge noted that FIC had had a successful year, but commented as follows about the future:

> The company appears to be among those paying the highest interest rates of comparable institutions. I am concerned whether the company will be able to maintain its profit position. In this regard I have prepared the following analysis of assets and the revenue derived from each.

	% of Assets	% of Revenue	Average
Cash	8.45%	4.60%	6
Bonds (Gov't.)	17.07%	10.31%	7
Bonds (Corp.)	10.04%	15.57%	19
Stocks	18.41%	27.03%	18
Mortgages	42.51%	38.55%	11
Investment in Monday Holdings	1.59%	1.37%	10
Other	1.93%	2.57%	16

> The average yield is determined by dividing the revenue for the year from the unconsolidated statement of income by the average of the opening and closing asset balances.
>
> The companies profit for this year and the past year is attributable to its excellent performance in the stock market. 55% of the revenue generated by the stock and bond portfolio came from gains on sales of securities. The only other major asset category whose percentage earnings exceeded the expense ratio is mortgages and this can be attributed to the unique place the company takes in the mortgages market place.

> Expenses for 1979 expressed as a percentage of assets were 9.95%. An analysis of these expenses breaks down to a [sic] approximate cost of 5.65% for accumulation deposits and 8.28% on single pay certificates and 2.77% for selling and administrative costs. The percentages for the certificates is based on the average liability balances and the selling and administrative costs on the average asset balances.
>
> In order for the company to achieve the current levels of profit in future years it must continue its present mortgage lending practices and obtain a substantial trading profit on its securities. [Exhibit 550 at 3-4]

The report on AIC, which incurred a loss in 1979, contained a similar comment. [Exhibit 551 at 19]

E. REGULATION OF FIC AND AIC IN THE 1980s

The annual examination reports prepared by the Audit Section indicate that FIC and AIC were in financial difficulty from 1980 onwards. [Exhibits 550 and 551] According to the calculations of the Audit Section, FIC and AIC rarely met any of the s. 8 tests at any time from 1980 through June 30, 1987. The reports indicate that initially the companies' apparent problems stemmed from the increase in interest rates and deterioration in the performance of the stock market. Within a year or two, the full impact of the companies' lending practices became apparent.

1981

The Audit Section conducted desk examinations of the audited GAAP and regulatory statements of FIC and AIC as at December 31, 1980 in April of 1981. Eldridge noted that on the basis of the companies' numbers they met the s. 8 tests. [Exhibit 567 at 354 and 357] That was followed by the annual examinations for 1980 and reports by Eldridge in October of 1981. [Exhibit 550 at 16; Exhibit 551 at 32]

The 1980 annual examination reports stated that FIC and AIC failed to meet two of the three s. 8 tests: they did not have sufficient unimpaired capital, nor did they have sufficient qualified assets on deposit "within Canada". Further, they did not comply with the 25:1 ratio or the mortgage guidelines, neither of which was a statutory requirement.

Eldridge's calculation of capital impairment in the reports was as a result of reducing the value of the companies' bonds to market, something the companies had not done. Eldridge reported that during the course of the annual examinations, it came to the auditors' attention that FIC and AIC wanted to value their marketable securities pursuant to s. 29(2) of the *ICA*, due to the decline in market valuation. Eldridge stated that as a result of amendment of the *CBICA*, he was of the view that s. 29(2) of the *ICA* could no longer be used. FIC and AIC did not accept this view and the valuation of marketable securities became an issue between the Superintendent and the companies.

The failure of the companies to satisfy the "in Canada" qualification in the s. 8(c) test was due to their practice of holding U.S. securities in the United States. This practice had been discovered by the auditors during the course of their 1979 annual examinations, done in the summer of 1980. [Exhibit 550 at 1; Exhibit 551 at 18; 26983] The Audit Section took the view that these assets did not meet the requirements of s. 8(c), not being "within Canada", and "backed" them out of their calculation of qualified assets on deposit. By letter dated June 30, 1980 Pointe requested that these assets be returned to Canada [Exhibit 571 at 310], but that was not done. Rather, FIC and AIC disputed the necessity of keeping the assets in Canada, since it was cheaper and more convenient to keep them in the United States. [26989-90] Despite numerous requests by the Superintendent and ultimately a directive from Minister Koziak [Exhibit 478 at 111], the securities were not brought to Canada. After some four years of wrangling, Saleh asked Martin to obtain an outside legal opinion. Bercov was retained and as a result of his opinion [Exhibit 576 at 365], Saleh exercised his discretion under s. 8(c) to allow the assets to remain in the United States. [29124]

Eldridge reviewed the companies' performance in 1980 and the first six months of 1981 and noted that gains were attributable to the sale of securities. He stated that the companies' chances for a profit in 1981 were dependent on an upturn in the depressed stock market.

Eldridge noted that effective August 1, 1981 the companies were no longer selling one year term certificates with a fixed interest rate greater than the maximum approved reserve accumulation rate. He anticipated this would have an effect on future capital as follows:

> The company currently mainly issued certificates with a face rate of 4% and additional credits.
>
> When the company issues these certificate [sic] it sets up the corresponding reserve at 6%. The difference between the cash paid in and the amount of the reserve is paid to Principal Consultants Ltd., as selling fee. Consequently in subsequent years the company has to earn 2% (6% reserve rate — 4% face rate) over the life of the product to cover issuance costs. Added to this 2% is the selling and administrative costs to cover the company's operations.
>
> Last year the administration and sales cost expressed as a percentage of outstanding certificates was 2.45%. Consequently the company has to earn over 4% per annum to cover the cost of its funds. This may become more difficult over time as the company's supply of "cheap money" is slowly declining. The new money received by the company is coming in at the current competitive interest rates. The company is switching from fixed interest certificate [sic] to an additional credit concept. However should the company fail to pay current interest rates at time of issuance under the additional credit option it will find the investors will fail to renew their certificates. [Exhibit 550 at 30]

With respect to the auditors' review of mortgages, Eldridge noted that in 1980 FIC and AIC did not make any provision for a loss on mortgages. He reported that as at December 31, 1980 FIC had 64 mortgages in arrears 3 months or more totalling some $12 million, while AIC had 26 such mortgages totalling $3.9 million.

Eldridge reviewed maturities and stated that there was a current matching of maturities (liabilities to assets) in 1981, but that there was reason for concern in light of the deficit position brought about by the difference between cost and market in government bonds.

Eldridge closed both reports with the following comments:

> As with most financial institutions the present high interest rates have had a serious detrimental effect. The present market value of the company's assets are not sufficient to meet its liabilities. Before any action is taken by the Superintendent, I recommend the department as a regulatory body adopt a standard policy for all financial institutions under its administration such as trust companies, investment contract companies, insurance companies, credit unions, etc. which are affected by today's unforeseen high interest rates. I consider this to be an utmost priority of the department.
>
> It is apparent to me that this company is getting further away from the original concept of an investment contract company due to its increased volume of single pay term certificates. Mr. Marlin, in my discussions with him, acknowledges this and is looking into the possibility of moving one of the investment contract companies to the *loans Act* [sic]. This action would enable the new company to obtain Canada Deposit Insurance. I recommend we consider the future of the *Investments Contract Act* and the nature of those companies licenced under it. [Exhibit 550 at 35; Exhibit 551 at 50]

Shortly thereafter, the Audit Section received and reviewed the November 30, 1981 monthly financial statement on FIC. [Exhibit 567 at 398] Eldridge noted the effect on income of the high interest rates paid to certificate holders in 1981 (income before taxes had decreased from over $3 million in 1980 to just under $250,000 in the eleven months of 1981). He again noted that FIC was using s. 29(2) of the *ICA* in valuing its securities, but had not obtained the approval of the Superintendent of Insurance as the provision required. Eldridge calculated FIC's capital position to be a deficit of

$437,338 when securities were written down to market value. Eldridge also noted that since June 30, 1981 FIC had acquired over $2 million in real estate through foreclosures.

Prompted by Eldridge's calculation of impaired capital, Pointe recommended to Kaiser that the matter be immediately brought to the attention of FIC and suggested that consideration be given to making a Special Report to the Minister. [Exhibit 567 at 405] In a follow-up memorandum to Kaiser on February 4, 1982 Pointe reiterated that he felt the capital situation serious enough to be brought to the Minister's attention. [Exhibit 571 at 541]

1982

As a result of the 1980 annual examinations and Eldridge's desk examination of the November 30, 1981 financial statements, Kaiser sent a compliance letter to Marlin on February 24, 1982, wherein he itemized the major areas of concern to the regulators. They were:

1) The use of s. 29(2) of the *ICA* to value securities rather than s. 29(1)(e);
2) The capital deficiency in the amount of $437,338 resulting from valuing securities in accordance with s. 29(1)(e);
3) The fact that the market value of FIC's bonds was approximately $8 million below book value;
4) The "very erratic" receipt of monthly financial statements;
5) The holding of U.S. securities outside of Canada;
6) The value of the security behind a $2 million subordinated note due December 31, 1993 from PGL.

Kaiser concluded the letter by saying that:

> The situation of the capital impairment is most urgent and I would ask that you take immediate steps to rectify the situation and to advise me how you intend to accomplish this. [Exhibit 552 at 628]

Kaiser, together with Keown, Saleh, Pointe and Eldridge met with Marlin and Gary Smith on March 8, 1982 to discuss the matters outlined in the February 24 letter. The regulators were advised that an additional $3.2 million had been added to the capital of FIC and $800,000 to that of AIC by way of subordinated notes. Kaiser noted in a memorandum to file that he was assured by Marlin and Smith that the companies would do whatever was necessary to ensure that their capital remained unimpaired. [Exhibit 567 at 422]

The use of subordinated notes as capital was evident by 1974 and was originally intended as a temporary measure. Then, at the instance of the Superintendent of Brokers in British Columbia and as a result of a significant stock market drop, PGL had guaranteed, by way of debentures, that FIC would not suffer an impairment of capital or deficiency of qualified assets on account of the devaluation of securities in its portfolio. In return, FIC provided PGL with promissory notes totalling $3.3 million which were subordinated to the claims of all creditors of FIC. The notes stipulated that they could not be repaid without the prior approval of the Superintendent of Brokers and Superintendent of Insurance. [Exhibit 482 at 237; 20745; 22404-5]

The evidence shows that the use of subordinated notes turned out not to be temporary, but continued in the 1980s. As reviewed below, throughout the 1980s the regulators were concerned about the use of subordinated notes as capital. They wanted injections of permanent capital instead. Subordinated notes could be repaid and were therefore not permanent. They also accrued interest, which was an expense to the companies. Many of the later subordinated notes did not contain a stipulation requiring the prior consent of the Superintendent for repayment.

At the March 8, 1982 meeting, Marlin and Smith were told that FIC could no longer use s. 29(2) of the *ICA* in valuing securities [Exhibit 567 at 422], and in a letter to Smith, Kaiser confirmed that s. 29(2) was no longer applicable since the *CBICA* no longer provided for valuation of unduly depressed securities. Accordingly, securities were to be valued on the financial statements of FIC and AIC at market value rather than cost [Exhibit 567 at 426], which impacted on calculation of the s. 8(b) and (c) tests. Notwithstanding Kaiser's directive, the companies continued to value securities according to s. 29(2), and when challenged argued that they should be allowed some sort of averaging provision. [Exhibit 388 at 132; Exhibit 567 at 675-6] According to Eldridge the issue resolved itself as the market recovered. [27009-11; 27055]

In June, 1982, in preparation for the 1981 annual examinations, the Audit Section conducted a desk examination of the December 31, 1981 audited GAAP and regulatory statements. [Exhibit 567 at 428-38] Eldridge noted that according to the companies' numbers the s. 8 tests were met, although neither company had a 25:1 ratio as had been agreed to. He recommended to Kaiser:

> The company to March 31, 1982 has not been able to generate sufficient income to cover its reserve and additional credit expenses. The stock market has deteriorated since May 31, 1982. The general economic conditions are worse now, in my opinion, than anytime in 1981 or 1982. It appears to me that in order for the company to meet its capital requirements it will have to put in additional equity. Therefore we should determine as soon as possible the resources of the company to meet these capital requirements. I recommend we request a forecast/budget of the company's unimpaired capital and operations and if additional capital is required then we be advised of its source and the resources available to the company's owners.

The Audit Section's annual examination report on FIC for 1981 and the first six months of 1982 was completed on August 24, 1982. [Exhibit 550 at 37] It revealed that FIC did not meet any of the s. 8 tests, and did not comply with the 25:1 ratio (it was 172:1 as at December 31, 1981 and 262:1 as at June 30, 1982 according to the Audit Section) or the mortgage guidelines.

The report indicated that FIC lost in excess of $3 million during the first six months of 1982 and Eldridge anticipated further significant operating losses in 1982.

Eldridge calculated a deficiency in capital as at December 31, 1981 of some $28.6 million (based, *inter alia*, on backing out the amount necessary to bring securities to market value, the U.S. securities on deposit outside Canada, certain subordinated notes which had not been approved by the Superintendent and a shortfall in the required reserves).

Eldridge reported that as at June 30, 1982 FIC had $8.2 million in subordinated notes as part of its capital ($2.2 million worth was injected in 1981 to cover declines in stock prices and $3 million in 1982 to June 30 to cover operating losses). He opined that "in view of the almost $200 million of certificate liabilities the company should be putting up permanent capital and not be operating with a minimum of $500,000 and subordinated notes". He also recommended that the capital requirements of the *ICA* be changed from a fixed amount to an amount proportional to liabilities.

According to Eldridge, it was on this annual examination that the mortgage and real estate problem first surfaced. [27018] He noted that as a result of foreclosures, as at June 30, 1982 FIC owned properties valued at $4.7 million. He questioned the validity of recording the real estate realized on foreclosure at the values of the mortgages and recommended that the regulators have appraisals done on all properties in inventory and those mortgages 6 months or more in arrears for which no significant income was derived. He expressed concern over FIC's practice of capitalizing the interest on mortgages in arrears. He also recommended that FIC be asked to justify the lack of a reserve for loss on mortgages receivable.

Eldridge further noted that FIC was recording reserves at a higher rate (6%) than the fixed interest rate stated on the face of the contract (4%), contrary to the requirements of the *ICA* according to a verbal legal opinion from the Attorney General's office, resulting in a shortfall in reserves. This was referred to by the Audit Section as the "known portion of the deficiency in reserves" and was backed out of the calculation of unimpaired capital.

The verbal legal opinion Eldridge referred to was subsequently reduced to writing. [Exhibit 567 at 476] It stated that the rate at which interest was accumulated under s. 30 had to be stated in the contract. The Audit Section took that to mean that where the contracts did not specify a reserve rate, it was assumed to be the fixed interest rate stated on the face of the contract, namely 4%. [Exhibit 550 at 185; Exhibit 551 at 143-4]

The Audit Section's report on the annual examination of AIC for 1981 and the first six months of 1982 was completed on November 1, 1982. [Exhibit 551 at 51] Like FIC, the report revealed that AIC did not meet any of the s. 8 tests and did not comply with the 25:1 ratio (it was 98:1 as at June 30, 1982) or the mortgage guidelines.

AIC lost in excess of $800,000 during the first six months of 1982 and Eldridge anticipated further significant operating losses in 1982.

Eldridge calculated a deficiency in capital in AIC as at December 31, 1981 of some $7.8 million.

As at June 30, 1982 AIC had $1.7 million in subordinated notes as part of its capital ($.8 million was injected in 1981 and $.9 million in 1982, to cover declines in stock prices). Certificate liabilities totalled nearly $55 million.

As a result of foreclosures, AIC owned properties valued at $664,780 as at December 31, 1981.

Eldridge made the same recommendations in respect of AIC as he had in his annual examination report on FIC.

On December 7, 1982 Kaiser, Rodrigues and Eldridge met with Marlin, at Marlin's request, for the purpose of discussing the future of FIC and AIC and establishing a dialogue. Kaiser reviewed his draft compliance letter prepared as a result of the 1981 annual examination of FIC. Security valuation under the *CBICA* was discussed but not resolved. Kaiser advised Marlin that the regulators now had a legal opinion to the effect that the term certificates should be reserved "flat", that is at the 4% fixed rate assumed on the face of the contract. [Exhibit 567 at 441]

The capitalization of FIC and AIC was discussed. According to Eldridge "Marlin stated his usual complaint that these companies were being subject to the three controls, capital, asset depository and reserve rates and that other deposit-taking institutions have only one". Marlin stated that the intention was to build up the capital of the companies through earnings. The use of subordinated notes as capital was discussed and Kaiser stated he was still evaluating that method of financing and was not sure he would approve it. The maintenance of securities on deposit outside of Canada was discussed and Kaiser advised that the matter was still under discussion. The future of FIC and AIC was also discussed. According to Eldridge, Marlin acknowledged that FIC and AIC had changed and indicated a desire to obtain deposit insurance for one of the companies. The possibility of a provincial loans act was discussed as well as changes to the *ICA*. The meeting ended with Kaiser advising Marlin that a compliance letter would be sent out shortly. [Exhibit 567 at 441]

The compliance letter to FIC was dated December 9, 1982 and the one to AIC was dated December 14, 1982. [Exhibit 567 at 443 and 445] In the letters Kaiser itemized a number of concerns and requests arising from the annual examinations, including:

1) The continuing use of s. 29(2) to value securities;
2) The heavy losses the companies were encountering (Kaiser wanted budgets and forecasts for 1983);
3) The inconsistent manner in which monthly financial statements were being prepared, leading to an overstatement of capital (Kaiser requested that the practice of putting through

certain selling expense charges and administrative charges on a discretionary basis be stopped);

4) The practice of reserving on the contracts at an assumed interest rate higher than the guaranteed rate stated in the certificate itself (Kaiser said the practice appeared to violate s. 30 of the *ICA* and asked the companies to provide him with their comments on the spread between the guaranteed interest rate and the reserve interest rate);
5) The use of the subordinated notes (Kaiser advised that that was not an acceptable long-term solution to increasing permanent capital and invited comment from the companies);
6) The lack of a reserve for losses on mortgages receivable (Kaiser suggested that one be set up); and
7) The holding of U.S. securities outside of Canada (Kaiser said that was still being discussed by the regulators and the companies would be contacted shortly).

In closing, Kaiser stated that as a result of what appeared to be unrestrained growth of the companies with no corresponding increase in their capitalization, "The ratio of liabilities to capital is so far out of line with other financial institutions that some kind of remedy must be considered." He asked for Marlin's thoughts on the matter.

1983

Marlin responded to Kaiser's December 1982 compliance letters with letters on behalf of FIC and AIC dated January 28, 1983. [Exhibit 567 at 453 and 457] The letters and attached budgets and forecasts were presented by Marlin at a meeting with Kaiser, Rodrigues and Eldridge on January 31, 1983. [Exhibit 567 at 447]

With respect to the method of reserving, Marlin was not prepared to change the companies' practice of reserving on single pay certificates at an assumed rate higher than the rate stated as the guaranteed rate on the face of the certificate.

With respect to the use of subordinated notes, Marlin wrote:

> The subordinated notes are not intended as a long-term solution, but only as a bridge over a unique period of high interest rates that has created pressures for all financial organizations. It is the intention to remove these notes as soon as the interest rates stabilize and the company can operate normally within the requirements of the Investment Contracts Act.

As will be seen, the subordinated notes were not removed and permanent capital was never injected into the companies.

Marlin stated that a reserve for bad debts would be set up in appropriate amounts for both companies.

With respect to the deposit of securities outside of Canada, Marlin advised that the companies had an independent legal opinion that the practice was in compliance with the *ICA*.

With respect to a capital ratio, Marlin wrote:

> The question of the ratio of liabilities to capital has been reviewed many times in the past and it seems that the terms of the Investment Contracts Act, which sets out the capital requirements clearly, are not considered adequate or are not fully understood. To the best of our knowledge, the company has, in the past and will in the future, always comply with the requirements of the Act.

The evidence tends to show that Marlin conttinued to resist the application of a capital ratio, notwithstanding his earlier agreement to adhere to a 25:1 ratio. [Exhibit 389 at 70] The regulators raised the matter from time to time, and the Audit Section continued to calculate the capital ratio as part of the annual examinations until the figures became meaningless; however, FIC and AIC did not adhere to a 25:1 ratio.

At the January 31 meeting Marlin also advised that the companies were considering the possibility of FIC and AIC concentrating on different segments of the market, with one company as an investment contract company handling long term contracts and the other handling short term deposits and qualifying for CDIC coverage. The evidence shows that this was not done.

In July, 1983 Eldridge and Rodrigues reviewed the files on FIC and AIC and prepared for Saleh, the new Acting Superintendent of Insurance, a list of matters which were outstanding between CCA and the companies. [Exhibit 567 at 470] They were:

1. The U.S. securities being held outside of Canada;
2. The use by FIC and AIC of s. 29(2) rather than s. 29(1)(e) of the *ICA* in valuing securities;
3. The use of subordinated notes rather than the introduction of permanent capital; and
4. The maintenance of statutory reserves in accordance with s. 30.

The severity of the financial difficulties facing the companies was confirmed by Hutchison in his October 1983 annual examination report on FIC for the year ending December 31, 1982 and the first 7 months of 1983. [Exhibit 550 at 78] After reviewing the company's operations, assets, liabilities and capital and applying the s. 8 tests, Hutchison made these extensive findings, beginning at 149:

> (a) FIC borrowings from the public at June 30, 1983 are now in excess of $230 million and yet by Province of Alberta legislation they are only required to maintain $500,000 in capital a ratio of 460 to 1. The company is becoming more and more like a trust company and a borrowing to capital ratio of 460 to 1 was considered completely ludicrous. Other financial institutions handling comparable products are required to maintain a ratio of between 15 and 23 to 1 in regards to borrowings and capital.
>
> (b) 93% of the capital of FIC at July 31, 1983 as stated in the Statement of Assets etc. is financed by temporary capital (subordinated note).
>
> (c) The company has $21 million dollars in bonds and stocks in the U.S.A. in contravention of Section 8(c) of the Act.
>
> (d) The company has $4.2 million dollars in Carma, Daon and Nu-West and there is no market value. Nu-West, Daon and Carma bonds and debentures are currently in default. These debentures were excluded from capital calculations.
>
> (e) The company during 1982 incurred substantial losses of $4.3 million and during 1983 to July 31, 1983 incurred losses of $2.5 million.
>
> (f) The company has no provision in the subordinated notes that approval is required by the Superintendent for their release.
>
> (g) The company failed (by substantial amounts) all three of the recognized tests. The company failed the section 8b, 8c and section 8d tests by $28.4 million, $20.4 million and $22.7 million respectively at June 30, 1983.
>
> (h) A substantial portion of FIC mortgages which represent 50% of total assets were in arrears as follows:
>
> — At June 30, 1983 63.7% of FIC's mortgages were over 3 months in arrears and/or foreclosure action had commenced.
>
> — FIC had commenced foreclosure action on $39.2 million or 32.2% of their mortgages at June 30, 1983.

- Well over half of the dollar value of FIC mortgages at June 30, 1983 were over 3 months in arrears.
- Mortgages over 3 months in arrears and/or foreclosure action had commenced increased from $51.2 million at December 31, 1982 to $77.6 million at June 30, 1983 or 51.6% in a six month period.
- The mortgage portfolio at June 30, 1983 decreased by approximately 3 million from the level at December 31, 1982. It appears that FIC no longer considers mortgages as preferred investments for the company.
- Mortgage arrears at June 30, 1983 represented over 10% of the balance outstanding on mortgages, while at December 31, 1982 it was only 5.5% increasing by almost twofold since the year end.
- FIC has numerous high ratio mortgages, with some mortgage balances being higher than the appraised value of real estate.
- Over 41% of FIC mortgages at June 30, 1983 were on land, and 71.8% of these mortgages were over 3 months in arrears and/or foreclosure action had commenced. Foreclosure action had commenced on 42.6% of the mortgages on land.
- FIC had numerous large mortgages on land for development in substantial arrears.
- FIC, AIC and PS&T loaned out a total of $67 million to twelve borrowers and out of the $67 million loaned out $50 million or 74.6% were more than 3 months in arrears.
- 59% of the dollar value of FIC mortgages were funded on mortgages of .5 million dollars or more.
- FIC made 26 mortgages over $1,000,000 totalling $42.6 million for land development. Land development mortgages accounted for 31 out of the 67 mortgages made over $500,000.
- FIC at June 30, 1983 has capitalized $12 million in arrears interest to mortgages and it was considered questionable whether the value of the real estate backing the mortgage was sufficient in all cases. e.g. the carrying value of the asset is increasing while the market value of the real estate is decreasing.
- If FIC expensed arrears interest on delinquent loans rather than capitalizing it losses would increase by a staggering $12 million.
- FIC is continuing to capitalize interest on mortgages on projects in receivership.
- FIC is reluctant to foreclose on projects as they believe that the best people to manage and operate the property are the owners in most circumstances. However FIC also benefits as the company continues to capitalize interest on the property until title is transferred.
- FIC does not follow the mortgage guidelines in the Superintendent's letter of November 3, 1978 even remotely closely.

(i) The company has acquired a significant amount of real estate through foreclosure over the past 2 years as follows:

- The companys [sic] foreclosed real estate portfolio is increasing at alarming rates with a 130% increase during the year ended 1982 over the level held at December 31, 1981. The company's real estate portfolio has increased 41% since the year end and there is currently $39.2 million worth of mortgages being foreclosed on. In light of the above, FIC could become a real estate company if foreclosure continues at the same rate.

- FIC has some real estate on the books at values in excess of the appraised value in several cases.
- Out of $4,043,139 worth of real estate held by FIC at December 31, 1981, only $182,475 has been sold after 1.5 years after taking possession. Based on the fact that FIC is unable to sell repossessed real estate, this may indicate that it is overpriced and should be written down.

(j) The company's practice of offsetting deferred costs against certificate liabilities on the audited balance sheet was considered totally unacceptable and not within GAAP.

(k) The company is not properly reserving for its certificate liabilities. The known portion of deficiency in reserves at December 31, 1982 was $4.8 million.

(l) FIC is not always valuing real estate in accordance with GAAP. Real estate in some cases was valued higher than the most recent appraisal in the company's files.

(m) FIC plans to lend a portion of its funds to individuals and corporations on the security of their mutual funds. This appears to be an admitted asset under Section 63(2) of the Canadian and British Insurance Act.

(n) The company is paying rates of 17% on the subordinated notes to the parent. The old notes state that interest is waived unless the company shows a profit.

(o) FIC does not currently prepare a comparative statement of assets, certificate liabilities, etc.

(p) Numerous outstanding items from the 1981 audit have not been resolved.

(q) The company in August 1983 [paid a] mortgage brokerage fee of $333,935 on the brokerage of the Qualico two year 8% mortgage. It is my opinion that since a low interest mortgage was given that the brokerage fee should be amortized over the life of the mortgage rather than brought into income in the period received. This 8% mortgage on raw land was renewed at 8%.

(r) The waiving of or reduction of administrative charges to the parent was considered inappropriate. It was noticed on the August unaudited financial statements that administrative charges for August 1983 were substantially reduced to the parent. This was a subject of concern in 1981 and the company stated it would no longer follow this practice but appears to be starting it again.

(s) The company is using the cost rather than the yield method of amortizing bonds. The difference is not considered material.

Hutchison concluded the report with a number of recommendations for action. [Exhibit 550 at 154-7] He recommended that FIC be made to comply with the s. 8 tests, failing which the Superintendent should seriously consider submitting a Special Report to the Minister pursuant to s. 37 of the *ICA*. He recommended that FIC be requested to convert its subordinated notes to permanent capital and that the capital requirement be changed from $500,000 to a floating amount based on borrowings from the public. He further recommended that the regulators have appraisals done on all properties in inventory and those mortgages 6 months or more in arrears not producing a significant amount of income. Other recommendations included requesting FIC to properly reserve for certificate liabilities at the rate set in the contracts, produce budgets and forecasts for 1984, inject permanent capital to cover operating losses, return the U.S. securities to Canada and justify its small reserve for loss on mortgages receivable.

Eldridge agreed with Hutchison's findings and recommended to Saleh that appraisals be done on all major real estate holdings and mortgages significantly in arrears and that the Director of Trust Companies be involved, because some of the properties and mortgages were owned jointly with PS&T. [Exhibit 567 at 520] Shortly thereafter Eldridge, with the approval of Martin, committed $20,000 from his own budget for the purpose of appraisals. Three separate appraisers were engaged and 16 appraisals on 14 properties with a book value in excess of $23.5 million were carried out. [Exhibit 552 at 765] The appraisers were asked to determine values on the basis of a reasonable sale period (6 months) and a forced sale. They were given Public Works Canada guidelines for assistance. [Exhibit 563 at 11]

1984

On January 10, 1984 Hutchison provided Eldridge with an update to his annual examination report on FIC based on his review of the November, 1983 interim financial statements and December 31, 1983 mortgage arrears reports. [Exhibit 567 at 527] Hutchison reported that in November FIC repaid $2 million of its $8.2 million in subordinated notes without notifying the Superintendent and notwithstanding a slim operating profit to that point in the year. The amount of real estate FIC had foreclosed on had increased threefold over the year and the mortgage portfolio was deteriorating badly. Hutchison concluded that it was "essential" for the regulators to obtain as many appraisals as possible to determine the value backing the certificate liabilities and to see that permanent capital was injected into the company or that subordinated loans were properly subordinated.

The next day Darwish forwarded two copies of Hutchison's update to Martin, one for him and one for the Minister. At the same time he told Martin that it was "absolutely essential" that funds be provided to do appraisals on all of FIC's properties. [Exhibit 567 at 526A]

On January 12, 1984 Saleh delivered a compliance letter to Marlin with respect to Hutchison's 1982 annual examination report. [Exhibit 567 at 531] Therein Saleh stated that FIC failed to meet any of the s. 8 tests and that such failure, together with the continuing operating losses and use of subordinated notes as capital, was prejudicial to the interests of the contract holders. He requested a meeting with company representatives and their accountants.

Martin and Osterman were aware of this and subsequent compliance letters sent by Saleh. Martin said the substance of such letters was discussed with him and demands for capital approved by him. These letters were discussed with Osterman so that in the event of representations on behalf of the companies to the Minister, she would not be surprised. [30199-200]

Saleh had ample opportunity to advise and did advise the Deputy Minister and Minister of problems with FIC and AIC. Saleh met bi-weekly with Martin as a matter of course [29235] and according to Martin, Saleh had ready and open access to Osterman. [30176]

Both Martin and Osterman testified that they accepted the capital deficiency as presented by Saleh in the January 12 letter and regarded it as serious. [30203; 30952-3] Martin believed that the Superintendent had discretion under the *ICA* to allow the companies to operate even with such a deficiency, at least for "reasonable periods of time", while the Superintendent and companies tried to resolve the problem. According to Martin, Saleh looked to him and to Osterman for direction in exercising that discretion. [30202-3]

The direction given by Martin was to the effect that FIC and AIC should be given time to work out their problems. Martin testified that this was based on what he perceived to be the unwritten policy of CCA in response to the Dial Mortgage and credit union crises, namely to do everything humanly possible to maintain the existence of Alberta financial institutions as long as possible. [30278-81] Upon conveying information about FIC and AIC to the Minister, he received no indication that action should be taken to close down the companies; rather his instruction, which he relayed to Saleh, was to work with the companies to see if their problems could be worked out. [30184-6]

Marlin responded to Saleh's compliance letter with a letter of his own dated January 16, 1984 in which he denied that FIC had failed to comply with the requirements of the *ICA*. [Exhibit 567 at 543]

The meeting which Saleh had requested was held on January 25, 1984. Martin, Darwish, Saleh, Rodrigues, Eldridge, Hutchison and Pointe attended from CCA and Marlin, Petracca, Campbell and Patrick represented FIC. Nothing was resolved at the meeting. There was no indication from company officials that additional capital would be injected. Marlin advised that FIC had recently repaid $2 million of subordinated notes to PGL (without the knowledge of the Superintendent) because the decline in the market value of securities which had prompted that injection had disappeared. He also said that one way to solve a capital shortage was to stop paying additional credits. [Exhibit 567 at 546; 27080-1]

FIC officials left an "Information Package" with the regulators which addressed some of the matters set out in Saleh's letter, namely the valuation of Carma, Daon and Nu-West debentures, the known deficiency in reserves alleged by the Audit Section, the use of subordinated notes and a budget for 1984. [Exhibit 567 at 553-86] Significantly, it did not address the regulators' concern about the value of mortgages and foreclosed real estate. The Audit Section reviewed the Information Package. It did not alleviate any of their concerns. [Exhibit 567 at 590-4]

In a conversation with Petracca in February of 1984, Martin asked the companies to prepare a plan of action showing how they were going to work out their problems. [Exhibit 580 at 117] He testified that "I wanted to see some kind of plan of action because we were — the company was in non-compliance and the Superintendent had some obligations there. I wanted to see what kind of workout the company was going to devise for themselves". [30210] No such plan was presented to the regulators, although from time to time the companies would forward income projections, which the Audit Section rejected as being unrealistic.

In February, 1984 Hutchison completed his report on the annual examination of AIC for 1982 and the first 7 months of 1983. [Exhibit 551 at 92] It revealed that the financial condition of AIC was as bad, if not worse, than that of FIC and Hutchison made similar recommendations for action.

Saleh prepared a draft memorandum to Martin dated February 24, 1984 reporting on the capital impairment calculated by the Audit Section in the 1982 annual examination reports and the results of the independent appraisals to date. He then said:

> Having considered our auditors' reports and the appraisals obtained so far, it appears that I am obliged under Section 37 of the Investment Contracts Act to make a special report to the Minister pursuant to subsections (c), (d) and (e) of the said section. [Exhibit 576 at 318]

Saleh testified that although he believed a state of affairs existed which was prejudicial to the interests of the contract holders, he did not forward the draft memorandum to Martin because he thought it would be prudent to first ask for an independent investigation of the companies "to strengthen the position of the government at the time". [29492-6] Saleh first raised the matter of an independent consultant in July, 1984, as discussed below.

Throughout February and March, 1984, Hutchison continued to review the companies' portfolios of mortgages and real estate. By April, he had received and reviewed the independent appraisals. All but one showed that the book values were far in excess of current market values, requiring writedowns in the range of 63-65%. [Exhibit 567 at 598-614] Osterman testified that these specific figures were not brought to her attention, but she knew that the appraisal results were a matter of "great concern". [30963-4]

Hutchison had called for further appraisals on all major owned properties and mortgages significantly in arrears. By memorandum from Martin to Darwish dated February 29, 1984 that request was denied. The memorandum, which was copied to Osterman and Saleh, stated:

> I have authorized the allocation of funds for the audit unit to conduct certain appraisals of real property owned or held as security by certain financial institutions.

> I am given to understand that these appraisals have confirmed what is already common knowledge of the highly depressed market values of real property in Alberta and in other parts of the country.
>
> In view of the important role that the various financial institutions play in the economy of our province and the unusual economic hardships most of them are experiencing as a result of unduly depressed market values of real estate, I will be discussing the situation with the Minister.
>
> In the meantime, I would ask that no further appraisals of this nature be conducted until further notice from my office to you. [Exhibit 552 at 754]

Darwish replied that he did not believe the situation of FIC was the same as that of other financial institutions and asked to be allowed to attend the referenced discussion with the Minister. [Exhibit 552 at 760] Darwish testified that he was "taken aback" by Martin's memorandum. He stated that this was the first time in his career that he was prevented from obtaining information he felt was necessary. [25473-4]

In anticipation of a meeting and upon becoming aware of Transaction #1, Darwish prepared and forwarded briefing notes dated March 2, 1984 to Martin describing the situation of FIC, together with a covering memorandum dated April 24, 1984 and stamped "Urgent" advising Martin that immediate action had to be taken to protect the contract holders in view of Transaction #1 (the details of that transaction are described elsewhere in this Report). The March 2 notes read:

> 1. The company completely ignored guidelines sent to them setting out limitations on the size of investments. They proceeded to make huge investments without any regard whatsoever to the amount of capital they had and the discussions that were taking place between them and our department at the time.
> 2. They placed huge mortgages on undeveloped, speculative real estate.
> 3. They consistently pay higher interest rates in order to attract deposits than do other companies and therefore have to invest in more speculative types of mortgages and real estate in order to earn for themselves sufficient income to pay these high rates.
> 4. The present condition of their foreclosed real estate and mortgage portfolio is one of the worst, if not the worst, that the Audit Unit has examined.
> 5. The company continues to accrue interest on mortgages that haven't received a payment, in some cases, for over two years.
> 6. At the same time as accruing the above-noted interest, the company sets up grossly inadequate allowances for bad debts. Thus, the combination of item #5 above and this item overstates the company's profits. (See item #18 following.)
> 7. At the time when the company seriously needed permanent capital, they had the effrontery to withdraw $2 million from their company to pay off a "so-called" subordinated note to their parent company thus further exposing investment contract-holders (the public) but at the same time protecting their own interests in the parent company.
>
>   I use the word "effrontery" because at the meeting that we held with company officials, they stated that the $2 million was only put up during a time of depression in the securities market and now that this depression was gone, they felt entitled to withdraw the $2 million. They did not even mention the fact that their mortgage and real estate portfolio was many times worse than any drop in the securities market.
>
>   In essence, we have a serious need for capital because of bad investments coupled with withdrawal of capital which, of course, makes the situation far worse than it was.
> 8. Because of the high interest rates that the company offers, it attracts many thousands of Albertans as investors but unfortunately, these investors do not have the protection

of the Canada Deposit Insurance Corporation. Should this company fail, the effect on the confidence in financial institutions in Alberta would be serious.

9. I was shocked at the meeting with the company officials when they indicated on a number of occasions that one way in which they could solve their financial problems would be to pay their contract-holders only the guaranteed amount (4%) and not pay them the additional credits that had been held out to them, but not guaranteed, in the amount of 7% or 8%. They pointed out that if they did this, they would immediately generate a substantial amount of capital. That they even contemplate such a move is irresponsible.

10. The appraisals to date reveal that this company is not simply faced with an unfortunate situation relating to investments in mortgages at a time when the economy is depressed and real estate values have weakened, but that imprudent and speculative investments have been made which reflect unfavourably on management.

11. Other companies in the mortgage and real estate business, such as Daon, Carma and Nu West, must value their properties at market. This has caused all these companies to default on various debentures and notes. In order to obtain financing, they must deal with their bankers or the public marketplace. No banker or investment dealer would lend funds on the basis of inflated values for assets. Thus, there is a third party balance to financing these companies. They are not blessed with unlimited cash flow.

    It is for this reason that administrators of Acts relating to financial institutions must ensure that proper valuations are used. Failing this, more and more investors place money with the company when they shouldn't. There is a heavy-duty placed on an administrator. That is why Provincial and Federal Governments have auditors to analyze the financial statements from the point of view of the investing public, not the shareholders.

12. We have learned of a non-arm's length transaction whereby $9 million worth of accounts receivable have been sold by the parent company of First Investors to First Investors. Thus, First Investors gives up $9 million and the parent company gives up accounts receivable. I am concerned about this transaction. If the accounts receivable were good, why would they not stay with the parent company? Is First Investors' cash being used for the benefit of the parent company?

13. This group of companies, which includes First Investors, Associated Investors and Principal Trust, does not hesitate to use the name of Superintendent of Insurance when they deal with their contract-holders. An example is correspondence that Associated Investors directed to a Mr. Robbins [sic] copy attached.

    You will see that throughout the letter of February 23, 1984, there are four references to the Superintendent of Insurance and one reference to a deposit held by a Canadian chartered bank and there is even a reference to their independent auditors. In the letters of February 1, 1984, and November 8, 1983, are references to the deposit being held with the Canadian chartered bank. As we know, this is incorrect.

    The references to the Superintendent of Insurance are probably a contravention of Section 46 of The Investment Contracts Act and if they aren't, they certainly come very close to it.

    The February 23, 1984, letter is of real concern when one realizes the serious financial problems that Associated Investors has.

14. I have referred to other companies in the Principal group because they are all linked together, they are owned by the same person, and many of the appraisals done to date are on properties in which the two investment contract companies and the trust company all have a share in the investment. Thus, the appraisal deficiencies affect all three companies and in a material way.

Should one of these companies fail, because they are part of a pyramid, it is conceivable that all will fail or be seriously affected.

15. On January 4, 1984, the Superintendent wrote a letter to First Investors based on the auditor's report. This was followed by a meeting with company officials, at which department officials were instructed not to discuss items but to listen only. As far as I know, nothing further has been done.

    I am concerned that a situation similar to what developed with Paramount appears to be developing with F.I.C. We should be careful we don't repeat this scenario.

16. This company's problems are more far-reaching than simply the sale of investment contracts. The company's contracts are deemed under The Trustee Act to be an acceptable investment for a trustee. Before the company can comply as a trustee investment, however, it must be approved by the Securities Commission. In my opinion, this company should not be allowed to continue as a trustee investment. This decision is, however, up to the Securities Commission. Thus, we should advise the Commission of our concern about the financial stability of First Investors.

17. The financial statements of F.I.C. state that "Real estate obtained in satisfaction of debts", in the amount of $9,219,518, is valued at the lower of cost or net realizable value. The appraisals obtained to date indicate this is not correct.

18. The following is a calculation of First Investors unimpaired capital as at November 30, 1983:

Unimpaired capital as calculated by First Investors		$2,910,000
Deduct:	Difference between book value of mortgages ($7,900,000) and appraised value of underlying security ($2,700,000)	$5,200,000
Deduct:	Difference between book value of real estate ($5,000,000) and appraised value of real estate ($2,100,000)	2,900,000
		8,100,000
Impaired Capital		$(5,190,000)

    As may be seen, First Investors is in a seriously impaired position. The above calculation only gives effect to the appraisals that have been completed and I think that it is safe to say that other appraisals will also result in substantial reductions in values with the attendant increase in the capital impairment.

19. The company continues to accrue interest on mortgages that are in arrears. This was referred to on page 57 of the audit report where it states:

    > FIC at June 30, 1983 has capitalized $12 million in arrears interest to mortgages and it was considered questionable whether the value of the real estate backing the mortgage was sufficient in all cases. e.g. the carrying value of the asset is increasing while the market value of the real estate is decreasing.
    >
    > If FIC expensed arrears interest on delinquent loans rather than capitalizing its losses would increase by a staggering $12 million.

    Generally accepted accounting principles require that proper allowances be made for the possible loss on the loans in arrear.

    If First Investors used the same policy as the Bank of Montreal, it would provide an allowance for interest on loans 6 months or more in arrears. The total amount, according to information provided to me by the Audit Unit, would be $16,400,000 as at November 30, 1983. At that date the allowance for bad debts established by First Investors was $920,000, some $15,500,000 less than what would be required.

> Applying the same standard as the Bank of Montreal (and this is a reasonable standard), the impaired capital shown in item #17 above would be increased by approximately $7,500,000.
>
> 20. Accepting the company's unimpaired capital of $2,910,000, the ratio of capital to liabilities would be approximately 77 to 1. A ratio such as this for a company that essentially sells instruments similar to a trust company G.I.C. is very serious in itself. Making adjustments for the overstatement of the value of assets makes the situation completely unacceptable.
>
> In my view, the company does not meet the capital requirements under The Investment Contracts Act and there exists a state of affairs that is or may be prejudicial to the interests of its investment contract-holders.
>
> We should, therefore, ask the company to immediately rectify the capital impairment, consider taking such other steps as may be necessary such as curtailing or stopping the sale of investment contracts to the public, and discuss the need for the appointment of an administrator. The Securities Commission should also be advised of our concern with our recommendation that F.I.C. and A.I.C. be dropped as "trustee investments" under The Trustee Act. [Exhibit 552 at 773-77]

In his covering memorandum Darwish recommended that Transaction #1 be reversed and the companies be required to immediately inject the minimum amount of capital necessary for them to continue operating under the *ICA* . He further recommended that if FIC and AIC failed to do these things, a Special Report should be made to the Minister and the appointment of a receiver and manager recommended therein. In the meantime, Darwish believed that serious consideration should be given to curtailing the companies' licences. He concluded his memorandum as follows:

> In my opinion, Principal Trust has transferred, to use the terminology of the Crown Trust affairs, its soft assets to F.I.C. and A.I.C. We thus have a serious and emergency situation with respect to these companies. It is of such importance that I feel the Minister should be immediately advised and would suggest in this regard that you send her a copy of this memorandum and attachments. [Exhibit 552 at 771]

Saleh testified that he was unaware of this communication to Martin and did not discuss it with Martin or Osterman. [29142] Martin also testified that he accepted this information from Darwish as accurate and important. [30257-8]

No meeting with the Minister was ever held and no further appraisals were obtained. In response to his memorandum, Darwish received a telephone call from Osterman on April 30, 1984. She told him she did not want any more recommendations from him. [Exhibit 552 at 793] She testified that she did not regard the writing of such memoranda as part of his job, and she did not read the memorandum for content. [30966-8] She said Martin told her that the content of the memorandum was information she already had by way of her on-going discussions with Martin and Saleh. [31424] She said she was not aware of the recommendations Darwish made. [31427] The telephone call was followed by a meeting between Darwish and Osterman at which it was decided that Darwish would take early retirement in November. FIC and AIC were not discussed. Darwish testified that he feels he was fired or forced out of CCA. [25603]

Martin testified that the decision to "defer" further appraisals was his, although Osterman was aware of it. His stated reason for doing so was that appraisals were unreliable because there was no market for real estate, a belief which he said was shared by Osterman and Saleh. Martin took this decision with full knowledge that the appraisals done to date indicated writedowns in the range of 60% were necessary, that there was no other method provided in the *ICA* for valuing mortgages and real estate and that valuation was necessary in order to do the s. 8 calculations. Martin had no suggestions for alternate ways to do the calculations. Instead he said he urged Saleh and the Audit Section "to work with the companies to see if there was a common ground upon which they could resolve the problems of the companies". [30191-7]

Osterman's evidence was that she discussed appraisals with Martin and Saleh and it was agreed that they were unreliable at that time because of a perceived lack of a market. [30956]

In the absence of further appraisals, the Audit Section decided to attempt to calculate the amount of the decline in the value of the mortgages and real estate by extrapolating the figures from the appraisals obtained to all the owned properties and those mortgages 12 months or more in arrears. [Exhibit 567 at 615; 26412] Using this method, they calculated the shortfall in value at $52 million in FIC and $20 million in AIC as of May, 1984, not including the $23 million from Transaction #1. [Exhibit 567 at 618]

On May 11, 1984 Saleh sent a further compliance letter to FIC and AIC. [Exhibit 567 at 635] The letter had been approved in principle by Osterman and Martin and demanded a meeting with the companies and their external auditors "to discuss the immediate steps necessary to rectify the existing serious situation". Saleh wanted to discuss the reversal of Transaction #1, which he considered to be prejudicial to the interests of the contract holders, conversion of all subordinated notes to permanent capital, injection of capital to cover the shortfalls on mortgages and real estate, compliance with a 25:1 capital ratio and cessation of the practice of accruing and capitalizing interest on mortgages in arrears. Specifically, Saleh wanted a $72 million capital injection to cover the shortfall in the value of mortgages and real estate as calculated by the Audit Section. In the event the companies disagreed with that calculation, Saleh wanted an interim injection of $35 million and independent appraisals on all mortgages 3 months or more in arrears having a book value of $250,000 or more and all foreclosed properties in accordance with Public Works Canada guidelines.

Osterman testified that she was aware of the magnitude of the shortfall in the value of mortgages and real estate upon receipt of her silent copy of this letter. She did not recall whether there was any discussion about cancelling or suspending the companies' licences if the requested capital was not injected. [30980-1]

In the meantime, the Audit Section was reviewing the 1983 GAAP and regulatory statements, which were filed in May, 1984. These statements indicated that the companies met the s. 8 tests. Eldridge advised Saleh that the regulatory statements were unaudited and had attached an incomplete set of the notes attached to the audited GAAP statements (the missing notes related to Transaction #1 and contingent liabilities arising from mortgages and real estate). In his view, the regulatory statements were "misleading or improper". [Exhibit 567 at 647] The Audit Section wanted the companies to file proper audited regulatory statements, however that was not done. According to Eldridge, with the receipt of the 1984 statements the next year, the request was dropped. [27197]

With respect to Note 9 to the GAAP statements for FIC [Exhibit 272 at 48], both Darwish and Eldridge testified that they did not recognize it as a true going concern note. [25689; 27387-8] Hutchison said it was such a note [26468-9], however there is no mention of it in his 1983 annual examination reports. No particular action was taken by CCA as a result of the existence of the note.

The Audit Section was also reviewing Transaction #1 in more detail. Hutchison concluded that the transaction was detrimental to the investment contract holders and recommended it be reversed. Eldridge and Darwish concurred. [Exhibit 567 at 655-74] Darwish testified that Transaction #1 was "the most blatant abuse that I had ever seen perpetrated on these investment contract companies in all of these years of my being involved in the administration". [25488]

Saleh also agreed. He testified that he asked for a legal opinion on whether he had the authority under the *ICA* to effect a reversal of the transaction. [29137]

Martin testified that his confidence, and that of Osterman, in the ability of FIC and AIC to work out their problems was shaken by Transaction #1 and he gave Saleh authority to demand reversal of the transaction. [30261-2] Ultimately Bercov was retained to consider what authority the Superintendent had with respect to dealing with Transaction #1 and the capital impairment of the companies. [Exhibit 567 at 795]

On June 19, 1984 Marlin responded to Saleh's May 11 compliance letter with a letter of his own challenging all of the points raised by Saleh. [Exhibit 567 at 675]

On May 24, 1984 a task force on financial institutions was struck by the Priorities, Finance and Coordination Committee ("Priorities Committee") of Cabinet. The task force was chaired by CCA Minister Osterman and its members included the Provincial Treasurer (Hyndman), the Attorney General (Crawford), the Minister of Municipal Affairs (Koziak), the Deputy Provincial Treasurer (McPherson) and CCA Deputy Minister Martin. The task force reported to the Priorities Committee. According to Osterman, its mandate was to review the impairment facing financial institutions governed by provincial statutes (trust companies, investment contract companies, credit unions, co-operatives, mortgage companies and insurance companies) and bring forward a plan of action. [30999-1001] She testified that almost immediately the prime candidate for review was the credit union system, and that remained the focus of the task force throughout 1984 and 1985. [31001-3; 31010] On occasion, Osterman would report to this task force that "there is continuing concern without resolution of the status of the two investment contract companies". [31052-3]

Hyndman testified that the task force was aware that there were differing legal opinions with respect to the *ICA* and the companies' compliance with it, and a dispute as to the valuation of real estate. According to Hyndman, Osterman indicated that she was monitoring the situation and he assumed that she was "carrying out whatever was necessary with respect to what should be done with those differing opinions". He said that there was never any suggestion that FIC and AIC were insolvent or close to it or that they would be "taken down". Hyndman also said that the task force was not advised of the magnitude of the shortfall in the value of mortgages and real estate as calculated by the Audit Section. [33731-5; 33784-5]

The only mention of FIC and AIC at meetings of the task force that McPherson could recall was a verbal report by Osterman on Transaction #1; she said that capital was being put in and the matter worked out. [32202-3]

On June 15, 1984 Saleh, Martin, the Director of Trust Companies (Pointe) and others from CCA, together with representatives from the federal Department of Insurance, met with Marlin and others to discuss Saleh's May 11, 1984 letter. Marlin conceded that there were serious problems with mortgages and real estate but felt if given time they could be worked out. Petracca advised that on May 8, 1984 FIC and AIC stopped declaring additional credits on certain existing single pay certificates to save money (they were reinstated in July). The affected contract holders were not advised of this, nor would they know, because the stoppage only applied to those contract holders who held contracts with no interest or principal payments due or coming due in the immediate future. Saleh testified that he did not take any action to compel the companies to notify prospective investors of this as he was concentrating on the "major issues", being the capital deficiencies and Transaction #1. [29173-4]

When asked by Saleh at this meeting how much capital PGL would be willing to put up, Marlin said none. [Exhibit 567 at 684]

Another meeting was held on June 15, involving Martin, Saleh, Darwish, Pointe, Stone (Deputy Director of Trust Companies), the federal Superintendent of Insurance (Hammond) and representatives of CDIC (Sabourin, de Lery and Sicotte). Its purpose was to discuss PS&T. However, during the course of discussion, Hammond expressed concern about the financial position of FIC and AIC, since any failure of those companies would automatically result in a negative impact on PS&T and CDIC would be in danger of having to pay depositors of PS&T. [Exhibit 571 at 936]

On June 29, 1984 CDIC notified PS&T that it was of the opinion that PS&T was following unsound business practices, in that its total borrowings were substantially in excess of the limit CDIC believed appropriate and it was not matching the maturities of assets and liabilities. CDIC was particularly concerned about Transaction #1, which it believed might have been illegal. PS&T was told that it had 30 days to remove the unsound practices, failing which CDIC would terminate its policy of deposit insurance.[Exhibit 363 at 39] Osterman was copied with CDIC's letter. She testified that she viewed that situation as serious and directed that a close relationship be maintained with CDIC to monitor developments. She was kept advised of the situation as it progressed through 1984. [30993-5] According to Martin, they were concerned about the effect a shutdown of PS&T might have on FIC and AIC. [30303-4] By letter dated September 27, 1984 CDIC withdrew its notice to PS&T on the basis that satisfactory progress had been made in remedying the unsound practices. [Exhibit 571 at 1006]

On July 9, 1984 Saleh wrote a confidential memorandum to Martin. [Exhibit 552 at 1045] He described the situation as "critical" and made the following request:

> Under the Investment Contracts Act, I am required to make a decision as to the amount of capital and reserves required to provide for losses on mortgages and real estate held by FIC and AIC. That decision must be made on proper and practical evaluation of the two companies' mortgage and real estate assets and at the same time take into account the protection of the interests of the companies' contract holders.
>
> Because of the current economic downturn and depressed real estate market experienced by our province and because of the importance of the decision that has to be made, I would request the Minister's permission and yours to solicit outside professional advice from a firm of chartered accountants of the Minister's choice, for an overall assessment of the financial position of FIC and AIC based on proper valuation of their assets and practices and at the companies' expense.

Saleh testified that he was seeking permission because while he had the statutory power under s. 32 of the *ICA* to engage an outside consultant, he did not have the "administrative power" (i.e., the ability to authorize payment) within CCA. From discussions with the Deputy Minister and Minister, he understood that he needed their express instruction. [29195-7]

In response to his memorandum, Martin and Osterman met with Saleh. He said he told them of Marlin's stated intention not to put in any capital. According to Saleh, Osterman and Martin told him they were not prepared to engage an outside consultant because that might cause a run on the companies and erode public confidence in financial institutions. Saleh was to give the companies time to work out their problems. He was to keep putting pressure on them by way of meetings and demands, but he was not to threaten to cancel or suspend their licences because "that would trigger the whole thing". [29197-202] Martin's evidence was that this instruction to Saleh was based on the "hope" of Osterman that the real estate market would recover. [30315-21]

On July 17, 1984 Saleh and Martin met with Marlin, Petracca and James Cormie and indicated that they would continue to work with FIC and AIC and give them time to attempt to work out their problems. [30322-4; Exhibit 389 at 102]

In August, 1984 the results of the 1983 annual examinations were reported. [Exhibit 550 at 169; Exhibit 551 at 131] With respect to FIC, Hutchison concluded that:

> FIC is virtually insolvent, has a severe capital shortage, is losing approximately $1 million a month from operations and is dependent on new customers deposits to pay off existing customer deposits and to subsidize the company's losses.
>
> In addition FIC is reluctant to put additional capital into the company, does not follow direction from the Superintendent's office and is entering into large transactions with non-arms length companies (without advising the department) that are prejudicial to contract holders.

> It is my belief that if a large amount of additional capital is not injected into the company immediately they could incur severe cash flow problems once the public learns that their 10% to 18% certificates are only earning 4%.
>
> FIC at present does not have the cash, liquidity or the resources to support even a minor run by their customers as most of their assets are in non current mortgages, real estate and long-term bonds.
>
> The cash flow problems and lack of capital is what caused the demise of our Provincially licenced mortgage brokers and it is my belief that this company is headed in this same direction and that the crunch could be near.
>
> FIC's current problems are no different than the problems facing many of the large Alberta based Credit Unions which made large speculative type loans during the boom years to investors financed by high interest rate term deposits. When the property values fell substantially the mortgagor stopped making payments, and the institutions were stuck with a lot of foreclosed properties (non-income producing in many instances) and mortgages badly in arrears and are still required to pay the high interest rates to their customers.
>
> FIC (similar to Credit Unions) is operating in many ways like a bank, although, with little or no capital. [Exhibit 550 at 225]

His conclusion with respect to AIC was identical, except that AIC was losing approximately $360,000 a month from operations. [Exhibit 551 at 178]

Eldridge testified that these conclusions were deliberately worded strongly to highlight the situation, which he regarded as very serious. [27136-7]

Hutchison's calculation of the s. 8 tests showed huge deficiencies in all three, as a result of backing out the writedowns on mortgages and real estate calculated by the Audit Section, the writedowns of bonds to market value, the known portion of deficiency in reserves, subordinated notes, U.S. securities not on deposit in Canada and other items. The capital ratios were described as "staggering" (376:1 for FIC and 115:1 for AIC using the companies' figures). Hutchison also calculated liquidation values of assets versus liabilities and reported a shortfall of over $73 million in FIC and over $21 million in AIC. He testified that he did this calculation because he did not think the companies would last much longer. [26416]

Saleh could not recall whether he gave copies of these reports to Martin, but in his meetings with him told him that the problems were escalating. [29232] Osterman testified that neither Saleh or Martin conveyed to her Hutchison's conclusion that the companies were virtually insolvent. [31304]

Hutchison also testified that in the summer of 1984 while he was doing the 1983 annual examinations, he noted for the first time a lack of cooperation on the part of company officials. [26465] He believed FIC and AIC were "playing accounting games" with the Audit Section with respect to their cessation of additional credits, discretionary waiving of levies and interest on subordinated notes, intercorporate transactions and failure to set up proper reserves for mortgages and real estate. [26539] He characterized these practices as "desperate moves made by FIC and AIC to make things look better than they actually were". [26541]

He cited as one instance of the lack of cooperation a failure by Petracca to provide documentation with respect to Transaction #3 [Exhibit 281] when asked by the auditors during the annual examinations. [Exhibit 567 at 731] This transaction (which is described elsewhere in the Report) resulted in $17.2 million cash leaving FIC and AIC in return for preferred shares in AHL, a loan receivable and agreements for sale. It was first brought to the regulators' attention at the June 15, 1984 meeting and since then the Audit Section had been requesting particulars of the deal. Eventually the documentation was provided and Hutchison was assigned to review and report on the transaction. He concluded that the transaction was:

> . . . a complete sham as no company, especially a company (Carma) on the verge of bankruptcy with serious cash flow problems is going to pay over book value for bonds that have a market value of only 30¢ to 35¢ on the $1 and pay over book value for a $7.8 million mortgage that has a [sic] appraised value of the underlying property of less than $1 million . . . [Exhibit 563 at 285]

Further, Eldridge was of the opinion that shares in AHL was a prohibited investment under the *CBICA* and therefore prohibited under the *ICA*. Saleh agreed. [Exhibit 567 at 852-6] Thereafter, according to Eldridge, "discussions go forward with the company and they start coming with legal opinions" to the contrary. [27184-5]

The regulators were given approximately one week's notice of Transaction #3. However, in most instances, the regulators found out about the intercorporate transactions after they took place, contrary to the companies' agreement in 1975 that they would obtain the prior consent of the Superintendent. [27468-71] The evidence tends to show that the regulators overlooked or forgot about that agreement, as there is no evidence of the regulators mentioning it in challenge to the intercorporate transactions carried out in the 1980s.

In the meantime, Saleh began to question the shortfall in the value of the mortgages and real estate as calculated by the Audit Section, as a result of advice by FIC and AIC that some of the properties on which the auditors had projected a loss had actually been sold for a profit through Transaction #3 [Exhibit 552 at 1047], and receipt of Touche Ross & Co.'s July 18, 1984 letter [Exhibit 526 at 181], which was taken as supportive of the approach of the companies to the valuation of mortgages and real estate.

A series of meetings were held between the regulators, management and Touche Ross & Co. into the fall of 1984 to review the accounting policies for mortgages and real estate and provisions for loss. The Red Book referred to earlier was presented and reviewed. No agreement was reached as to the proper method of valuation nor the value of the portfolio. The Alberta regulators understood that management treated the mortgages and real estate as long term investments which were experiencing a temporary decline in value. The Audit Section took the position that the decline in the value was permanent and therefore the values should be written down. In the end, Eldridge advised Saleh that while he still stood by the shortfall calculated by the Audit Section, it could not be supported without a great deal of research and cost. He also advised that the approach he understood was followed by Touche Ross & Co. was within GAAP. Accordingly, he recommended that the companies be requested to inject sufficient capital to cover the contingent exposure on the mortgages and real estate as calculated by Touche Ross & Co. ($13 million), plus whatever Bercov determined to be the loss to FIC and AIC on Transaction #1. [Exhibit 567 at 781-94 and 799-805; 27396-8] I note elsewhere in this Report that as at December 31, 1983 Touche Ross & Co. had audited the financial statements to ensure, within GAAP that the real estate was carried at the lower of cost and market value.

Saleh testified that after the meetings with Touche Ross & Co. he went again to Martin and Osterman for authorization to engage a consultant to conduct an independent investigation of FIC and AIC to attempt to resolve the disagreement between the companies and the Audit Section over mortgages and real estate and the financial health of the companies. His request was again refused on the basis that it might result in a run on the companies and have a domino effect on other financial institutions. He was told to wait and see how the companies would do on their own with the help of their external auditors. He testified that the prevailing view was "there was always hope that the real estate market would come back". [29244-5]

In October, 1984 Hutchison updated his annual examination reports with a desk examination of the monthly financial statements of FIC and AIC to July 31, 1984. He concluded that it was becoming more and more evident that the companies were "headed for serious financial disaster and additional capital is urgently needed". He recommended considering suspending the companies from selling further certificates to protect future consumers. In his view, had FIC and AIC been borrowing from a bank rather than from "unwary customers", they would have been put in receivership long ago. These updates were given to Saleh. [Exhibit 567 at 764-72]

In a memorandum dated October 29, 1984 Eldridge highlighted for Saleh the significance of an increase in certificate liabilities which had been noted by the Audit Section and the difficulty the companies might have in the future in generating a sufficient return. [Exhibit 567 at 742] The memorandum, which is reproduced in its entirety, said as follows:

> During our meeting of October 2, 1984 I questioned Mr. Marlin as to the reason why FIC was increasing its certificate liabilities ($54 million from December 31, 1984).
>
> This increase appeared to me to be higher than the financial institution "norm". Mr. Marlin stated a [sic] increase in certificate liability is necessary to provide an increased asset earning base as the company has a significant amount of non income producing assets.
>
> The reserving method for certificate liabilities permits an investment contract company to record an instant profit the day the certificate is sold.
>
> An example is a 2 year certificate for a $1,000 with a face rate of 4%, and a reserve rate of 6%. The reserve set up on the day the certificate is sold is $962.61 permitting a gross profit of $37.39. The $37.39 is paid out to Principal Consultants Ltd., the sales agency. There would be direct selling expenses such as salesman commission and advertising but a profit would remain within the Principal Group. This profit could find its way in FIC or AIC as a commission income or reduced operating or other costs or could be retained by Principal Group Ltd. (PGL).
>
> The result by increasing sales now is to mortgage future years income and the company is obtaining income it needs now to survive.
>
> To attract these funds FIC and AIC have to pay attractive interest rates. Principal Savings and Trust Company (PS&T) in published interest rate comparisons is always at or near the top in interest rates paid and the contract companies are usually ¼% higher than PS&T.
>
> The result is in future years the company will have to earn on its investments the interest rate payable (includes face and additional credits) plus 2% being the amount necessary to increase the reserve to the maturity value plus an amount necessary to cover overhead. Overhead at present for 1984 expressed as an annual percentage of certificate liabilities is 3%. Assuming a present interest rate in excess of 12% the company would have to earn 17%. Since the company has reduced its mortgage activity I am not aware where the company could place its additional funds to earn the income needed to cover these liabilities.
>
> Therefore the expanding of liabilities for an investment contract company is not similar to the financial institutions they compete with; credit unions, banks and trust companies. These financial institutions do not create income when they issue a certificate as an investment contract does.
>
> As at December 31, 1983 FIC had $15 million in cash and $245 [sic] in certificate liabilities and at September 30, 1984 FIC had $4 million in cash and $299 million in certificate liabilities. During this period we are aware that $23 million in FIC went to PS&T for payment of mortgages and real estate and $17 million went to Carma for preferred shares and loans. It does not appear that the assets received for this cash will be able to generate the aforementioned earning ratio.
>
> One could assume from the preceding that $40 million of the certificate increase and cash change from Dec. 31, 1984 to date of $65 million was used in the PS&T purchase and the Carma swap. Both of these transactions produced assets to FIC of what appears to be limited earning power.

On November 29, 1984 Saleh held a special meeting with Osterman and Martin and others to discuss the companies. The Minister was provided with a written summary of the companies' financial position. She was advised that Bercov opined that Transaction #1 contravened the *ICA* (but that the Superintendent had no express power under the *ICA* to order the transaction reversed) and that an $11.3 million capital injection was required to avoid a loss to FIC and AIC. [Exhibit 567 at 795; Exhibit 580 at 234] In accordance with Eldridge's recommendation, Saleh wanted a further injection of $13 million based on Touche Ross & Co.'s contingency note to the 1983 financial statements. [Exhibit 567 at 858] Saleh presented a draft letter addressed to FIC and AIC demanding that $24.3 million be injected prior to December 31, 1984 in order for them to continue to be licenced. [Exhibit 576 at 851] That letter was not sent because Martin told Osterman that he had met with Marlin and had promised him an opportunity to meet prior to the Superintendent taking any action. [Exhibit 580 at 238]

A meeting was held on December 14, 1984. Several days later, an agreement was reached whereby PGL injected $11.3 million in cash into FIC "solely for the purpose of curing the harm caused" by Transaction #1 and took back subordinated notes which could not be repaid without the approval of the Superintendent, in return for Saleh not seeking to reverse the transaction. [Exhibit 567 at 881]

Left unresolved was the matter of a further injection of capital to cover the shortfall or potential exposure of FIC and AIC on mortgages and real estate ($13 million). On the basis of assurances by Marlin that the 1984 audited financial statements would show improvement in the companies' condition, Saleh and Martin agreed to defer a demand for further capital until receipt of those statements. [29267-9; 30356-7]

Martin testified that as at the end of 1984 he and Osterman were still prepared to grant the companies time to see if their problems could be worked out. By a workout he meant a general improvement in the economy and the companies with the passage of time. [30358-9]

1985

The financial condition of FIC and AIC continued to deteriorate in 1985.

By memorandum dated January 29, 1985 Hutchison advised Eldridge that Johnson had indicated that FIC was now declaring additional credits at the end of the quarter and that interest was no longer being accrued monthly for additional credits, but was only being credited to customer accounts at the end of the quarter up to the date of the quarterly anniversary of the certificate. [Exhibit 567 at 888] Hutchison commented:

> This is a very significant change in accounting treatment and was only picked up by our review of the fluctuations in additional credit interest expense from month to month on the company's financial statements. It shows again the fact that FIC is deliberately providing the department with misleading financial information which is used to monitor the company.
>
> **Conclusion**
>
> The method currently used by FIC to record additional credits materially understates both liabilities and additional credit expense and I recommend that company officials be required to account for additional credits in the correct method.
>
> In addition we are receiving more and more evidence that the company officials can no longer be trusted e.g., Carma sale, PS&T sale, misleading monthly financial statements, misleading mortgage reserves, misleading real estate values, stopping and reinstatement of additional credit interest, expense, etc. and it is therefore essential that we obtain quarterly audited financial statements that can be relied on.

The Audit Section received and reviewed the 1984 audited GAAP and regulatory statements for the companies in March, 1985. The GAAP statements disclosed that general mortgage and owned property reserves had been appropriated from retained earnings in the amounts of $10.2 million and

$2.2 million for FIC and AIC respectively. Using the companies' own numbers and backing out these reserves, Eldridge found that AIC met none of the s. 8 tests while FIC met them all. [Exhibit 567 at 899-908] In a subsequent desk examination as at March 31, 1985 however, Romalo calculated a deficiency in capital for FIC of $.7 million. [Exhibit 567 at 932]

As described earlier in the Report, the 1984 audited financial statements were based on a change in the method of valuation of owned property. Owned property was classified as land that was held for resale, income-producing or held for development. [Exhibits 272, 273 and 274] Land held for resale was considered to be inventory and was described in the working papers as raw land that produced no income and had no development potential within 5 to 7 years. The other two were considered long term investments: income-producing property was held to generate income; and land held for development was held in order to develop the property and then generate income. [Exhibit 534 at 1-6] The Audit Section was aware of these classifications. [26242-3; 27065] There is no evidence that the Audit Section or CCA ever considered whether s. 36 of the *ICA* prohibited the holding of land for development.

Section 1(g)(ii) of the *ICA* provides that "qualified assets" means first mortgages on improved real estate. "Improved" is not defined and the Audit Section was not provided with a definition. [37854-5] Historically, the Audit Section had backed out mortgages on unimproved or raw real estate from qualified assets. Eldridge testified, however, that no such deduction was made in 1981 through 1984. [37864-5] He said that was because the matter did not come to his attention; had it, they would have been backed out. [37867-8]

It is apparent that any such deduction would impact on calculation of the s. 8 tests. According to the annual examination reports, the companies had significant investments in mortgages on unimproved or raw land. For example, in his 1982 annual examination report on FIC [Exhibit 550 at 78], Hutchison broke down mortgages by type and reported that at June 30, 1983 FIC had some $43 million worth of mortgages on raw land. Similarly, in his 1983 annual examination report on FIC [Exhibit 550 at 170], Hutchison reported that 38% of the dollar value of FIC's mortgages, or some $48.3 million was on raw land. The evidence tends to show that had these amounts been deducted, FIC and AIC would have failed to meet the s. 8 tests independent of the dispute over the value of mort gages and real estate.

A second task force was struck by the Priorities Committee in April, 1985 to monitor the financial position of Alberta trust companies. This task force was chaired by Provincial Treasurer Hyndman and included Osterman, Crawford, McPherson and Martin. [Exhibit 582 at 135] Hyndman described the policy of that task force as follows:

> . . . the policy was to deal with problems as they arose as recommended by individual Ministers when they felt that the seriousness had reached such a stage that be there should be work-out plans developed. The policy was that when these recommendations came from Ministers, that then the task force would have to get to work . . . [33759]

With respect to FIC and AIC he said "These two companies, or their situation, was not brought forward at any time as being a situation of serious urgency requiring major time and attention by the task force". [33744] The only information which the task force might have passed on to the Priorities Committee about FIC and AIC was that Osterman had advised of "ongoing difficulties", but there was no recommendation for urgent action by the task force. [33765]

The only written report Hyndman saw detailing the problems with the companies was a two page summary attached to a November 15, 1985 memorandum on Alberta financial institutions he sent to Premier Getty and the Priorities Committee. [Exhibit 588 at 8; 33765-6] That summary, which was prepared by Eldridge and Saleh, referred to the capital impairment as calculated by the Audit Section, the operating losses and the valuation of mortgages and real estate, and concluded as follows:

> Should the final determination of the outstanding legal and valuation issues prove to be unfavourable to the two companies, the situation may call for the suspension or cancellation of the registration of the companies unless the principals have the financial resources and the willingness to cover the deficiency. It is possible that the regulators might have to invoke the provisions of the Act with respect to receivership and/or liquidation of the two companies in the circumstances.

Notwithstanding this conclusion, Hyndman testified that any mention of FIC and AIC at the presentation of his November 15 memorandum to a meeting of the Priorities Committee held on November 18, 1985 would have been "very peripheral". The main focus was on credit unions, banks and trust companies. Hyndman did not recall any discussion with respect to FIC and AIC. [33766; 33813-5]

Hyndman testified that at no time during the period 1984 to 1986 did Osterman ever communicate to either task force that FIC and AIC were operating without meeting the financial tests under the *ICA*. He believed he would have remembered if he had been so advised as he would have been alarmed. [33799-800; 33829]

McPherson's recollection was similar. He testified that it was not until November, 1985 that the second task force became aware of problems with FIC and AIC. He could not recall if the summary was discussed, but said the members would have seen it. He thought the perception of the task force was that CCA was still trying to determine whether the companies were complying with the *ICA*. [32212-5; 32227]

Hyndman also testified that during the period 1984 to 1986 Osterman would, from time to time, in Cabinet meetings give an overview of the companies, along with other financial institutions. He recalled Osterman saying that there were on-going problems which she was monitoring. She made no recommendations for action. [33804-6]

Osterman testified that FIC and AIC were not discussed on a regular basis or in any detail at the meetings of either task force. She described her reports on the companies at these meetings by saying "It would only be once in awhile in my overview that I would say that there is continuing concern without resolution of the status of the two investment contract companies". [31052-3]

With respect to the Priorities Committee, Osterman testified that in verbal presentations she advised that there were concerns about the companies within CCA and major unresolved issues that would eventually have to be dealt with. [31055] Osterman testified that she advised the Priorities Committee in 1984 and 1985 that CCA believed the companies' capital to be impaired, but that their external auditors did not, and that the matter had yet to be resolved. [31108-10]

Osterman further testified that neither task force ever made recommendations about FIC or AIC to Cabinet, nor did the discussion about FIC and AIC at the November 18 meeting give rise to a decision or course of action with respect to the companies. [31167-8; 31122]

She testified that as the Minister responsible for investment contract companies, it would have been incumbent upon her to bring any significant matters with respect to FIC and AIC to Cabinet's attention. Her evidence was that in 1984 she told Cabinet that CCA believed these companies were in trouble while their external auditors said they were not. She did not advise Cabinet of specific concerns such as the valuation of mortgages and real estate, the intercorporate transactions or the requests for appraisals and an independent consultant, because she was not bringing forward a plan of action with respect to the companies. [31319-23]

Donald Getty, who became Premier of Alberta on November 1, 1985, gave evidence by way of statutory declaration that he had no knowledge of any financial difficulties in the Principal Group of Companies, including FIC and AIC, until informed by Johnston in about February, 1987 that some Government action might be necessary. [Exhibit 609]

In a memorandum to Saleh dated July 8, 1985 Eldridge listed the items he felt should be resolved with respect to FIC and AIC. [Exhibit 567 at 961] They included the following:

1. The capital deficiencies as reflected in the companies' unaudited March 31, 1985 financial statements, totalling some $2.3 million (Eldridge said the companies should be requested to put in additional capital);
2. The operating losses which totaled some $6.2 million to March 31, 1985 (Eldridge said the companies should be requested to supply a forecast of profit and loss for the balance of 1985 and first half of 1986, supported by a comfort letter from their external auditors, plus some form of assurance that they had access to additional capital to cover projected losses);
3. The status of the companies' investment in AHL;
4. Whether the subordinated notes relating to Transaction #1 should be segregated from other capital;
5. The delay in receiving the monthly financial statements.

According to the Audit Section, the companies incurred operating losses totalling $7 million to April 30, 1985 as a result of not earning enough income on assets to cover the interest expense to contract holders. Approximately 40% of their assets were non-income producing or produced substantially less income than current market yields. Saleh met with Marlin on July 17, 1985 to discuss this situation, but no formal demand for capital was made pending direction from Osterman and Martin. [Exhibit 580 at 269]

On July 18, 1985 Saleh forwarded a report to Martin informing him that the companies were sustaining substantial losses that could top $20 million for 1985. He advised that the 1984 audited financial statements recorded the potential exposure of FIC and AIC resulting from the decline in the value of mortgages and real estate at $12.2 million, and that in the absence of further appraisals he accepted that figure. He also advised that preliminary information from the Audit Section, which was in the midst of its annual examinations, indicated that the companies' liabilities exceeded their assets by $10 million, which, when added to the companies' losses to date in 1985, showed capital deficiencies totalling $15.2 million without considering any writedown in the value of mortgages and real estate. [Exhibit 567 at 973]

Although there is no reference to it in the July 18, 1985 report, Saleh testified that in his discussions with Martin and Osterman he still wanted to engage an outside consultant. It was considered, but not pursued because of the continuing concern about a run on FIC and AIC and a domino effect on other financial institutions. Threatening cancellation or suspension of their licences was also discussed with Martin and Osterman and rejected, leaving Saleh to continue requesting management to take action to remedy the problems. [29313-8]

With the approval of Osterman and Martin, Saleh sent another compliance letter to Marlin on August 2, 1985. [Exhibit 567 at 983] In it Saleh outlined the capital deficiencies as calculated by the Audit Section and advised that these deficiencies brought into question the validity of the companies' registration in view of the requirements of s. 8 of the *ICA*. He requested that Marlin give this matter his immediate attention and provide him with projections of earnings and losses, the source of funds to cover expected losses and the steps management intended taking to rectify the capital deficiencies.

In response, FIC and AIC for the first time challenged the manner in which the s. 8 tests were done by the Audit Section. [29318-9; 30402] At a meeting on August 8, 1985 Johnson told Eldridge that Donald Cormie had reviewed the *ICA* and took the position that the calculations should be done in accordance with GAAP. Johnson presented calculations that showed that when done in that fashion, FIC and AIC satisfied the s. 8 tests at that time. [27223-5]

Johnson also told Eldridge that there were no resources within PGL to provide further funding for FIC and AIC. [Exhibit 567 at 996 and 1001]

In September, 1985 Canadian Commercial Bank ("CCB") and Northland Bank ("Northland") collapsed. [843; 1754] According to Martin, these failures intensified his desire and that of Osterman to try to preserve Alberta-based financial institutions. [30411-2]

In early September the reports on the 1984 annual examinations became available. [Exhibit 550 at 281; Exhibit 551 at 422] According to the Audit Section, neither company satisfied any of the s. 8 tests. Romalo, who prepared the reports, calculated the capital deficiencies as at December 31, 1984 at $10 million for FIC and $24 million for AIC. In view of the lack of further appraisals (which the Audit Section still wanted) and the acceptance by the Audit Section of the mortgage and real estate figures presented by the companies and their external auditors, Romalo's figures did not include the huge writedowns which Hutchison had included the year previously. [27237; 26786-91] Additionally, Romalo did not back out several other items which Hutchison had the year before. [26791-803] Accordingly, the deficiency figures for 1984 were significantly less than those calculated by Hutchison for 1983, although the financial picture of the companies had not improved. [27556-7] According to Saleh, this was not drawn to his attention. [29330-1]

Shortly thereafter, Romalo reported on his review of the companies' August 1, 1985 to July 31, 1986 projections of income and expenses. He concluded that they were unreasonable and unrealistic. [Exhibit 567 at 1027]

By memorandum dated October 22, 1985 Eldridge summarized for Saleh the major areas of concern the Audit Section had with respect to FIC and AIC, as follows:

1. The capital impairment of the companies as at December 31, 1984 as reported in the annual examination reports;
2. The continuing losses, which as at October 31, 1985 totalled some $12.8 million;
3. The companies' position with respect to the manner in which the s. 8 tests were to be calculated;
4. The eligibility of the shareholdings in AHL;
5. The overall lack of capital within PGL;
6. The recently recognized decline in deposits with FIC and AIC and PS&T;
7. The companies' practice of speculating in real estate through granting loans at below current interest rates and participating in any profits of sale (which had been brought to Eldridge's attention by Johnson and an example of which was Transaction #5);
8. The real estate valuation problems. [Exhibit 567 at 1043]

The operating losses continued through the balance of 1985. On January 8, 1986 Eldridge forwarded to Saleh analyses of the companies' unaudited statements as at November 30, 1985 which showed net losses totalling some $15.7 million, and advised Saleh that the disparity between the actual and projected income figures was increasing. Saleh forwarded these analyses to Martin. [Exhibit 567 at 1124-8]

With respect to the dispute as to the proper calculation of the s. 8 tests, Saleh obtained an independent legal opinion from Bercov dated January 15, 1986 to the effect that the s. 8(b) and (d) tests but not the s. 8(c) test could be done in accordance with GAAP. [Exhibit 567 at 1146] Thereafter, with Saleh's concurrence the Audit Section calculated the s. 8(b) and (d) tests in that manner. [29364-6]

With respect to the lack of capital within PGL, the Audit Section, Saleh and Martin were aware that PGL was raising money from the public through the sale of promissory notes. According to Eldridge, there was little liquidity in PGL. In his view, it was the "most vulnerable" of the Principal

Group of Companies. The regulators were concerned that if there was a run on PGL, it would impact on the investment contract companies and PS&T. [29334-5; Exhibit 567 at 1034-6] Osterman was also aware that PGL was in shaky financial condition. [31576-7]

With respect to the companies' shareholdings in AHL, Eldridge advised Saleh that in the opinion of the Audit Section the investment was prohibited under s. 52 [formerly s. 33] of the *CBICA* by virtue of the indirect controlling interest of Donald Cormie in both AHL and FIC and AIC. [Exhibit 567 at 1068-70] This was notwithstanding legal opinions to the contrary proferred by the companies. [Exhibit 293 at 73 and 78] The Audit Section was also concerned about the valuation of the shares. Bercov rendered an independent legal opinion in which he concluded that s. 52 of the *CBICA* applied to FIC and AIC and they could not make investments prohibited under the *CBICA*. [Exhibit 567 at 1146] Saleh testified that he was then satisfied that the companies' investment in AHL was prohibited and so advised Martin. [29359] Martin testified that while he was aware that AHL was an issue, he was not familiar with the details and had no recollection of discussing the matter with Saleh or Osterman. In fact, he said that apart from Transaction #1, he had no recollection of discussing any of the transactions with Saleh or Osterman. [30339-40; 30543-4; 30785] Osterman testified that she was never aware of Transaction #3 and the dispute over whether the shares in AHL were a prohibited investment under the *ICA*. [31088; 31299-301] In any event, FIC and AIC continued to hold their shares in AHL. [28382]

At or about this time the Audit Section became aware of some transactions by which FIC and AIC acquired shareholdings in Matrix and PNI and embarked on an investigation as to whether they were permitted investments under the *ICA* and as to their value. [Exhibit 567 at 1096-113] Martin could not recall ever being aware of these transactions. [30422]

In November, 1985 CDIC proposed a joint examination by CDIC and CCA of FIC, AIC and PS&T. [Exhibit 580 at 288] According to Saleh, the proposal was prompted by CDIC's concerns about FIC and AIC. Saleh was in favour of the idea, however Martin felt it was "premature". [29339-41; Exhibit 580 at 297] His evidence was that he was concerned about focusing attention on FIC and AIC, particularly in light of the CCB and Northland failures. He also said it was pretty clear what an examination would show and CCA did not have a strategy in place upon which to act once the examination was done. [30422-3; 30434-9] No joint examination was done.

On November 21, 1985 the Deputy Superintendent of Brokers in British Columbia wrote to Saleh as a follow-up to a telephone conversation between them. [Exhibit 601 at 67] He informed Saleh that British Columbia was "becoming increasingly concerned as to the liability" of FIC and AIC and went on to say:

> We realize that if we prohibit the sale of the investment contracts in the province would in all probability result in the demise of the companies, but nevertheless, we feel that we must make a decision with respect to these companies in the near future. People are investing in these companies, and it may very well be that the companies are not meeting the statutory requirements.

At or about the same time, Saleh asked Eldridge to assist in preparing a report on FIC and AIC for the Minister. The Audit Section prepared a draft document dated November 5, 1985 and entitled "Suggested Letter from the Superintendent of Insurance to the Hon. Mrs. C. Osterman", summarizing what it believed were the major concerns with respect to FIC, AIC and the Principal Group of Companies, as follows:

1. Capital impairment — the draft stated that as at December 31, 1984 FIC and AIC contravened s. 8(b) of the *ICA*, with capital impairments of $10.1 million and $2.7 million respectively;
2. The method of calculation of the s. 8 tests by the Audit Section and the companies' disagreement with it;

3. Net operating losses and the waiver of intercompany charges to increase income;
4. The value of the companies' $34.2 million shareholdings in AHL — the Audit Section estimated the value of the shares to be roughly half of the book value;
5. The companies' speculation in real estate, by which owned properties were being sold for relatively little cash down with the balance by way of mortgages back at interest rates below current levels — the effect of such transactions was to replace real estate the value of which was the subject of disagreement between CCA and the companies with mortgages which were technically current;
6. The decline in August and September of customer deposits — the Audit Section stated that this was of concern since it was new money coming in that was being offset against the operating losses;
7. The problem in valuing mortgages and real estate — the Audit Section stated that the valuation affected the calculation of the s. 8 tests and therefore the determination of whether the companies should continue to be registered;
8. Transaction #5;
9. PGL notes and debentures payable — the Audit Section noted that as at December 31, 1984 PGL's liability under promissory notes and debentures totalled $68.5 million, some $20 million of which was owed to certain Hutterian Brethren colonies. The Audit Section opined that if the colonies withdrew their deposits PGL would collapse, which would have a "drastic effect" on FIC and AIC because of their substantial investment in PGL through their holdings of AHL shares. [Exhibit 567 at 1046]

Saleh could not recall what he did with the draft. [29337-8] Eldridge did not know what Saleh did with the draft, but he recalled attending a portion of a meeting in the latter part of 1985 at which Osterman, Hyndman, Martin and possibly McPherson were present. According to Eldridge, he, Saleh and Pointe were called in to discuss FIC and AIC. Although he could not recall the particulars of the discussion, he did recall Hyndman asking him if he saw any light at the end of the tunnel. His reply was no. [27272-5] Hyndman recalled that Eldridge was at one or perhaps two task force meetings, but did not recall either that question or answer. [33747-8] McPherson also recalled Eldridge and Saleh being at a meeting of the second task force, but did not recall such a question or answer. [32216-9] Osterman also did not recall such a question or answer. [31170-1]

Both task forces were disbanded in November, 1985 as part of a restructuring of the Government following Getty becoming Premier. [31091]

1986

According to Eldridge, the companies' situation worsened in early 1986 and Saleh and Martin were so advised. [27294-5] This was confirmed by Martin. [30444-5]

The December 31, 1985 audited GAAP and regulatory statements were not filed with the Superintendent until May 16, 1986, contrary to s. 27 of the *ICA*. Saleh had agreed to hold the companies' applications for renewal of their licences until receipt of the statements. Apparently the licences were prepared and signed by Saleh and indicated an effective date of April 1, 1986. They were not, however, delivered to FIC and AIC until May 16, 1986. [Exhibit 389 at 381; 28095-100] Martin knew of and concurred in this. [30468] The companies continued to sell investment contracts during the period April 1 to May 16, notwithstanding that they did not possess licences. Saleh was aware of this, as evidenced by his testimony as follows:

Q I take it, then, what you are saying is you, as Superintendent, were against the companies being allowed to sell the contracts when they didn't have a licence but — I'll stop. Is that correct?

A That's correct.

Q But you were, in effect, overruled by Mr. Martin?

A That's correct. In our meetings I was told that we shouldn't take any action to bring these companies down until we see their financial statements.

Q Did you discuss with Mr. Martin or say to Mr. Martin, well, they are doing this in violation of the law and I am the Superintendent charged with administering the Act? Did that occur to you?

A Well, I was telling him that we have a difficult situation in front of us. The companies are not licenced, they are selling contracts and so on in violation of the Act, yes, that's true.

Q Let's stop there, you say "we have". You had, you were the Superintendent, you had a difficult situation, didn't you?

A That's right.

Q And indeed, did you point out to Mr. Martin that, as Superintendent, you had a duty to see that they did not sell these contracts?

A That's correct.

Q He said to you, well, regardless it is a policy decision, we can't allow the companies to stop selling their certificates?

A That's correct. Not in these words precisely, but that is correct.

Q That is generally what he said?

A That's correct. [29709-10]

Martin said Saleh's evidence was essentially correct. He said Adair, the new Minister, was made aware of the situation, but no action was taken. [30475-6; 30796-7]

The GAAP statements (but not the regulatory statements) were qualified as a result of a disagreement between Deloitte Haskins & Sells and the companies. Deloitte Haskins & Sells felt that there had been a permanent decline in the value of certain mortgages and real estate, giving rise to writedowns of some $9.8 million for FIC and $1.7 million for AIC. The companies were of the view that since the *ICA* allowed them to hold such assets for up to 7 years, no writedowns need be taken until the end of that period. [Exhibit 567 at 1175-98; 27305-8]

Saleh testified that upon receipt of the 1985 GAAP statements there could no longer be any dispute as to whether FIC and AIC met the requirements of s. 8; they did not. In his opinion, there was no hope for the companies. He again recommended that the companies be examined by an independent firm of chartered accountants. When asked about cancellation or suspension of the companies' licences, he testified that that decision was not his to make. [29371-3; 29378-9]

In June, 1986 the companies asked to have the $11.3 million in subordinated notes which had been injected in respect of Transaction #1 treated as a general injection of capital, on the basis that there had been an improvement in the value of some of the transferred real estate. Eldridge recommended to Saleh that the subordinated notes not be released [Exhibit 567 at 1208-32] and they were not.

On July 11, 1986 interim reports on the 1985 annual examinations of FIC and AIC were available. [Exhibit 550 at 325; Exhibit 551 at 468] Even using GAAP, substantial capital impairment was calculated; nor did the companies meet the other s. 8 tests. In covering memoranda to Saleh, Eldridge anticipated that the companies would continue to record losses due to the low or non-income producing assets and recommended that the companies be instructed to inject sufficient capital to cover the impairment as May 31, 1986 (totalling some $15 million) and provide an acceptable plan of action to maintain their solvency. On July 28, 1986 final reports confirmed the findings of the interim reports. [Exhibit 550 at 341; Exhibit 551 at 481]

Upon receipt of the interim reports, Saleh prepared a report dated July 23, 1986 for CCA Minister McCoy, which he copied to Johnston. [Exhibit 576 at 1433] Therein he advised that the companies would continue to experience operating losses unless there was a massive injection of capital or replacement of low or non-income producing assets. He advised that the British Columbia regulators had refused to renew the registration of the companies unless they injected additional capital. Saleh warned that because of the close structure and relation of companies within the Principal Group of Companies, failure of any one company could seriously affect the others. Saleh advised McCoy that under the *ICA* he had a duty to take action in view of the capital impairment and substantial losses. He advised that he intended making an official demand on the companies for a $15 million capital injection and requested an opportunity for "discussion and direction". Saleh testified that he thought he also reported to the Minister or Deputy Minister the fact that British Columbia was withholding new licences for FIC and AIC until there was an injection of capital in the approximate amount of $11 million. [29389-91]

In response to his report, Saleh was referred to Treasury which, as a result of the transfer of administration of the *ICA* in June, 1986 had become responsible for FIC and AIC. What followed was a series of meetings between Martin, Saleh, McPherson, Kalke and members of their respective staffs. Saleh testified that he again raised the idea of an independent consultant. [29398-9] McPherson proposed that a formal notice be sent to FIC and AIC, which took the form of a compliance letter dated August 14, 1986. Therein Saleh notified the companies that unless they took immediate steps to rectify the $15 million capital deficiency by August 31, 1986 "I would have no alternative but to take appropriate action in accordance with the provisions of the Act". [Exhibit 567 at 1302]

It is useful to examine the conduct of Treasury upon its assumption of jurisdiction over FIC and AIC.

At the time of the transfer of jurisdiction, Treasury officials had discussions with Martin and Saleh and it was decided that the Audit Section would complete the annual examinations and reports, after which officials in the two departments would get together again for an in-depth discussion. [32235-6]

By the time of the in-depth discussion, Treasury had not only the final reports from the 1985 annual examinations, but also Saleh's July 23, 1986 memorandum to McCoy and Johnston. The contents of the reports and the recommendations in Saleh's memorandum were discussed by Saleh and McPherson. [32236-8]

McPherson testified that as a result, he knew two things in July, 1986:

1. The Audit Section and Saleh were saying that FIC and AIC did not meet any of the tests under the *ICA*, and
2. There were significant questions as to the viability of FIC and AIC.

He said he attempted to deal with the former item by sending the August 14 compliance letter and with the latter item by engaging an independent consultant. [32244-8]

In early August the annual examination reports were forwarded to Johnston under cover of a memorandum from McPherson which said in part as follows:

> 2. The recently completed audits (copies attached) on companies have identified significant deficiencies in the companies capital and therefore steps must be taken to correct them.

> 3. Contract holders are dependent on the financial ability of the company to repay their investments with accrued interest as investment contracts are not deposits covered by CDIC. It is unknown whether the companies will be able to correct the capital deficiencies. However, from past dealings with the companies, it is very likely that the companies will object to and disagree with the calculations used to demonstrate the deficiency. In view of the likely disagreement by companies' officials and the seriousness of the situation we plan to use the authority of the Act to engage an independent consulting firm to review the internally prepared audit reports to provide comments and alternatives for our consideration. Before we engage the independent consultant the Superintendent of Insurance and our Assistant Deputy Provincial Treasurer-Revenue will meet with companies to advise them of our general concern and that we will have an independent review of the companies' financial position.
>
> We will proceed accordingly unless you instruct us otherwise and we will provide you with further information and seek your direction after the independent review is completed. [Exhibit 590 at 27]

Johnston testified that he reviewed the 1985 annual examination reports and was not prepared to rely solely on them in making a decision with respect to the companies. [33271] Accordingly, he had no objection to an outside consultant.

An independent consultant was eventually engaged in late 1986. In the meantime, Treasury embarked on its own review and analysis of FIC and AIC using personnel from the Loans and Guarantees section under the supervision of George Kinsman. Loans and Guarantees was a group of financial analysts whose main responsibility was to review requests for Government guarantees on various types of financings, including requests by financial institutions for Government assistance. [32199-220] They had been involved in 1984 and 1985 in the review of credit unions and certain Alberta-based trust companies. [33397-8]

Kinsman testified that in 1984 he requested from Saleh and was provided with copies of Hutchison's 1983 annual examination reports on FIC and AIC. He wanted information on financial institutions as background on the credit unions' file. He indicated that he read those sections of Hutchison's report dealing with the analysis of balance sheet amounts and income and expense, from which he concluded that these companies had low or non-productive assets. He said he did not read the entire reports and was not aware of Hutchison's conclusion that FIC and AIC were virtually insolvent. [33398-405] Kinsman did not bring the existence of these reports to Kalke's or McPherson's attention at the time of transfer of jurisdiction to Treasury [32205; 33424], because in the summer of 1986 Loans and Guarantees was doing its own review of the interim annual examination reports, the Audit Section's working papers and the 1985 audited financial statements "as preparatory to potentially being involved in the analysis of these companies". It conducted a "high spot review" of these materials, from which Kinsman concluded that the companies had financial problems and were highly dependent on PGL for financial support. He did not at that time make any determination as to their solvency or viability. He testified that Loans and Guarantees conducted this review on his own initiative and McPherson was not advised until "quite later". [33424-9; 33434-47]

In August, 1986 Loans and Guarantees became "officially" involved with FIC and AIC when Kalke asked Kinsman to review the August 14 compliance letter. That involvement continued to June 30, 1987.

In the summer of 1986 the B.C. Superintendent of Brokers' office was in contact with the Alberta regulators. Certain of the British Columbia regulators were called to testify and their documents were tendered in evidence. [Exhibit 601]

The 1985 audited financial statements and regulatory statements were filed in British Columbia in June, 1986. They were reviewed by Bill Smith, who highlighted 3 major issues:

1. valuation of the shares of AHL, Matrix and PNI;
2. whether the shares were qualified investments; and,
3. valuation of mortgages and real estate. [Exhibit 601 at 83]

According to Smith, the primary test used in British Columbia was qualified assets on deposit. [34643] Smith calculated deficiencies in qualified assets on deposit in the amount $43.3 million for FIC and $12.1 million for AIC. [Exhibit 601 at 83-94] On the basis of these findings, Smith declined to renew the companies' licences and requested that they voluntarily stop selling investment contracts in British Columbia until these issues were resolved. Saleh was copied with that request. [Exhibit 601 at 96] Smith testified that in June, 1986 he also recommended to the Acting Superintendent of Brokers, David Edgar, that an independent consultant be engaged to do a comprehensive review of the companies. [34649]

Smith continued to monitor the companies. Upon receiving further information from Johnson, he reported to the new Superintendent of Brokers, Michael Ross, that he calculated the deficiencies in qualified assets to be $9.6 million for FIC and $1.7 million for AIC. This was based in part on valuing Matrix shares at 30¢ each. [Exhibit 601 at 290]

As a result of Smith's calculations, Ross sent a "compliance" letter to Marlin on July 4, 1986 demanding the injection of over $11 [illegible]ion before new licences would be issued. Saleh was copied with that letter. [Exhibit 601 at 292]

In a further report to Ross on August 1, 1986 Smith said as follows:

> To my mind little has changed with these two registrants and their poor financial condition. In my opinion there will be continuing monthly operating losses brought about by holdings of non-income producing properties . . .
>
> The continued non-arms length transactions to generate book profits does not instil any confidence in me. I would not personally invest $1 in either company and I can see no reason why any other resident of this province would do so if he had possession of the financial information known to us.
>
> I therefore continue to recommend that registration not be issued and that both companies be stopped from selling new investment contracts or rolling over existing investment contracts. As you are aware, they are presently selling without registration, which is illegal, and registration should be granted or refused. Continued operation in the twilight zone cannot be encouraged. [Exhibit 601 at 329]

On August 29, 1986 Marlin replied to Saleh's August 14 compliance letter, advising that "pursuant to the request of another regulator" some $11 million of qualified assets were being injected into FIC and AIC by way of promissory notes secured by mutual funds. He also enclosed profit plan projections for the next 9 month period. [Exhibit 567 at 1307]

Both Pat Visman of the Audit Section and Kinsman of Loans and Guarantees reviewed the documentation Marlin enclosed with his letter and had reservations about the security behind the notes and the reasonableness of the profit plans. [Exhibit 567 at 1313 and 1336] Meetings were held between CCA and Treasury. Rout from the Attorney General's office was included on Saleh's recommendation because Saleh did not think the notes were a proper capital injection under the *ICA*. [29404] At one of these meetings, on September 18, 1986, the solvency of FIC and AIC was discussed and the view was expressed that they were insolvent. Rout stated that they had to be stopped from taking in money. [Exhibit 567 at 1334-9] This view was based on the belief that the companies' liabilities exceeded their assets. [27354-6; 28922] According to Pointe, there was general agreement that steps should be taken to either stop prospective investors from purchasing certificates or "cure" the insolvency. [28918-21] Kalke was not as definitive; his evidence was that while the possibility that FIC and AIC may be insolvent was recognized, no decision was taken at the meeting that they were insolvent. [31701-2]

The regulators proceeded to engage an independent consultant, as had been proposed within Treasury in early August, but put on hold pending the August 14 compliance letter and the companies' response. The matter came to the fore in the fall of 1986 as a result of a memorandum from Kalke to McPherson dated September 26, 1986, as follows:

> You were aware that Rout, Rodrigues, Pointe, Eldridge, Kinsman & myself were meeting on Thursday (yesterday). Rodrigues attended as Saleh is away on vacation. The reason for meeting was what further steps should be taken in regards to the financial situation of these companies and in particular to review a draft letter developed by Saleh & Rout to companies. You will remember that at the meeting where you and Barry Martin attended it was agreed to promptly send a letter to companies (correspondence attached). Our group met on Thursday and I guess I really need your direction on two courses of action:
>
> (1) send letter as drafted
>
> (2) first seek an accountants view on meaning of section 8(b) (copy attached)
>
> The issue here is that the group is rather satisfied that these two companies do *not* meet requirements of section 8(b). Jim Rout feels very strongly that regulators have not done their job by insuring that section 8(b) was complied with, although the real serious financial problems of these companies occurred over past couple of years. Jim feels company should tell us with appropriate certification that companies meet requirements. We can then decide on next action. Frankly I don't think do nothing is an option. Guess I feel that matter is very important & perhaps we should arrange another Martin/McPherson (& others) meeting. Kinsman's view is that if companies responded saying they agree they don't meet requirements of section 8(b) then where do we go from there. Again my view is we must do something (we already advised Minister of serious problems) but perhaps we should in advance decide in meeting of Deputies the move if companies say they agree they don't meet requirements. If you agree I will set up meeting. [Exhibit 587 at 118]

The memorandum led to a meeting on October 30, 1986. McPherson, Martin, Saleh, Kalke, Rout and others were present. The situation was reviewed. Saleh voiced concern as to whether the companies would be able to avoid a going concern note in the 1986 audited financial statements and again suggested engagement of an independent consultant to evaluate the companies. A decision was taken to pursue a "business" rather than "legal" approach and engage such a consultant to evaluate the companies' ability to continue as a going concern and meet the requirements of the *ICA*. [Exhibit 567 at 1385-8] That decision was communicated by McPherson to Johnston in a memorandum dated November 4, 1986. [Exhibit 590 at 76]

By November, 1986 Kinsman in Loans and Guarantees was of the view that FIC was "effectively insolvent" and that the estimated losses to the end of 1986 raised doubts as to the companies' con tinuing viability. He was also in favour of engaging an outside consultant to address what he considered to be the two fundamental questions with respect to the companies:

1. Were they solvent under any realistic accounting definition?
2. Were they going concerns which would be able to meet their future financial commitments? [Exhibit 587 at 208-21]

By November, 1986 Smith in British Columbia expressed renewed concern about the financial conditions of FIC and AIC. He reviewed their unaudited financial statements as at September 30, 1986 and advised Ross that they were not meeting the forecasts provided by Marlin as a result of continuing losses. Smith recommended revocation of the companies' licences and stoppage of the sale of investment contracts. He also recommended that Ross contact the Alberta regulators to propose an immediate joint demand for a cash injection in the amount of the unaudited losses to September 30, some $7 million. [34745-8; Exhibit 601 at 346]

Ross testified that he did not pursue the idea of a joint demand because it would not have re solved the real problems. Ross was concerned about the operating losses and long term viability. He wanted an independent management consultant to determine the status of the companies and provide recommendations as to how to handle the situation. He talked to McPherson about this; McPherson agreed and told Ross that Treasury was looking for a consultant. Ross testified that he told McPherson that if Alberta did not get a consultant, he would. [36664-7]

On November 21, 1986 Kalke, Saleh, Rodrigues and Eldridge met with Marlin, Patrick and Johnson. The regulators were advised that PGL could not put large amounts of capital into FIC and AIC, but at the same time were told that PGL would inject whatever was necessary for the companies to meet the requirements of the *ICA*. [Exhibit 567 at 1398] Apparently there was no discussion as to what amounts were necessary. [27373-4]

By letter dated December 24, 1986 Price Waterhouse Limited was engaged, pursuant to s. 32 of the *ICA*, to inspect the books, documents and records of FIC and AIC and provide to the Superintendent the following:

> (a) an independent assessment of the present financial condition of the Issuers including whether the Issuers meet the qualifications for registration as set out in Section 8 of the Act, and a general review, assessment and valuation of the "qualified assets" of each of the Issuers and the security behind the notes receivable from Principal Group Ltd.; and
>
> (b) an appraisal and report on the ability of each of the Issuers to carry on business and to meet their obligations as they fall due. [Exhibit 587 at 280]

1987

On February 20, 1987 Wooldridge of Price Waterhouse Limited forwarded to Kalke a draft preliminary report setting out his findings, conclusions and recommendations to that point. [Exhibit 545 at 33] Wooldridge concluded that FIC and AIC were in "serious financial difficulty". His findings and conclusions summarized in the report were as follows:

> 1. We have not received sufficient information to enable us to evaluate the Companies' investments in and advances to related companies. In order to complete our review the Companies should be required to provide the information requested.
> 2. Trading of investments in related companies has resulted in the recording of profits and inflated asset values contrary to generally accepted accounting principles.
> 3. We have not received sufficient information to enable us to evaluate the Companies' investments in mortgages, agreements for sale and real estate owned. In order to complete our review the Companies should be required to provide the information requested.
> 4. The audited financial statements of the Companies as at December 31, 1985 indicate that substantial provisions for losses on real estate related assets were required at that time. Such provisions for losses have not been recorded in the December 31, 1986 financial statements we have reviewed.
> 5. We have completed an interim calculation that indicates that the capital of First Investors is impaired to the amount of approximately $24,000,000.
> 6. We have completed an interim calculation that indicates that the capital of Associated Investors is impaired to the amount of approximately $8,600,000.
> 7. We have completed an interim calculation that indicates that the deficiency of qualified assets less investment contract liabilities of First Investors amounts to approximately $64,500,000.

> 8. We have completed an interim calculation that indicates that the deficiency of qualified assets less investment contract liabilities of Associated Investors amounts to approximately $22,500,000.
>
> 9. Our calculations disclose that the yield being earned on investments is insufficient to cover interest being paid on investment contract liabilities and operating expenses. [Exhibit 545 at 35-6]

Wooldridge advised that based on the findings to date, it was highly unlikely that receipt of the information required to evaluate investments in mortgages and real estate and related companies would cause him to view the companies' financial position more favourably. He went on to recommend that the Superintendent should suspend or cancel the companies' registration on the grounds that they did not comply with the requirements of s. 8 of the *ICA*. He further advised that the Superintendent should make a Special Report to the Minister in accordance with s. 37 and recommend to the Minister that a receiver and manager or liquidator be appointed. Further, he advised that in his opinion the investment contract holders would, upon liquidation, incur a loss at least equal to the deficiencies calculated in the report.

The Price Waterhouse Limited draft report was forwarded by McPherson to Johnston on February 26, 1987. [Exhibit 590 at 80]

FIC and AIC were not given a copy, although Marlin and Johnson were allowed to read it and make notes. [Exhibit 587 at 392] As a result of what management perceived to be inaccuracies in it and a lack of understanding of investment contract companies by Price Waterhouse Limited, Donald Cormie engaged John Ryan and Bob Brintnell of Coopers & Lybrand Limited to assist in responding to the draft report and dealing with Treasury. A number of meetings were held in March, 1987 among Marlin, Johnson, Ryan, Brintnell, Wooldridge, McCutchen and Treasury officials to discuss the draft report. [Exhibit 518 at 11, 36A and 37-76]

On April 15, 1987 Marlin, Johnson, Ryan, Brintnell and McCutchen met with Kalke to deliver the draft 1986 audited financial statements for FIC and AIC. These statements [Exhibits 296 and 297] contained a going concern note as follows:

> 1. Continuing Operations
>
> The continued operation of the company is dependent on the company and the regulatory body agreeing to a satisfactory resolution regarding the deficiency of assets to the certificate liabilities and reserves and other liabilities, together with receipt of provincial licences that allow the company to continue to operate year to year.

At the meeting, Ryan voiced concern that the British Columbia regulators would react to the note and it was agreed that there should be a meeting with them to discuss the draft financial statements and the draft Price Waterhouse Limited report. [Exhibit 518 at 77]

In late April, 1987 Donald Cormie retained Jack Agrios, Q.C., as legal counsel to assist in dealing with the regulatory problems. [23340-1]

On May 7, 1987 a major meeting was held involving representatives of FIC and AIC, Ryan and Agrios, Deloitte Haskins & Sells (the companies' external auditors), Price Waterhouse Limited, Treasury, the Attorney General's office and the B.C. Superintendent of Brokers' office. It was agreed at the meeting that the companies and their consultants would prepare a business plan for all of the Principal Group of Companies. It was anticipated that development of the plan would take several weeks; in the interim, the companies and Treasury would meet every 4 days for progress reports. [Exhibit 518 at 85-91]

At one of the first of these meetings, on May 11, 1987, Agrios advised Treasury officials that FIC and AIC could not continue to operate and were not, by themselves, viable. [Exhibit 587 at 561A] This was the first time that anyone on behalf of the companies had expressed that opinion to the regulators. [31825-6] One week later, Agrios delivered to McPherson a binder containing 5 so-called "scenarios" or alternatives for action, all but one involving Government financial assistance. McPherson was advised that further scenarios were being prepared. [Exhibit 518 at 121]

On May 22, 1987 Price Waterhouse Limited forwarded its further draft preliminary report to Treasury. [Exhibit 545 at 251] That report advised, *inter alia*, as follows:

> The foregoing calculations indicate that the companies are not in compliance with the tests required by the Investment Contracts Act. First Investors is deficient by an amount of at least $14,000,000 and possibly by as much as $43,000,000 at December 31, 1986. Associated Investors is deficient by an amount of at least $9,500,000 and possibly by as much as $18,000,000 at December 31, 1986.
>
> A review of the financial statements of the Companies indicates that approximately 25% to 30% of the qualified assets are invested in owned property which is a non-earning asset. Overall calculations indicate that the Companies are earning in the range of 6% to 8% on their qualified assets and are obligated to accrue 10% to 12% on their contract liabilities. As a result the Companies are incurring 4% to 6% negative margin on their operations before expenses. In the case of First Investors, 4% negative margin equals approximately $12,000,000 loss and in the case of Associated Investors, 4% negative margin equals approximately $4,800,000 loss. These margin losses may be offset by security gains and distribution fees to be earned.
>
> It appears that any proposed resolution to the present financial circumstance must address additional capital to meet the statutory requirements, the prompt liquidation of the owned property and investment of the proceeds into earning assets and the contribution of additional earning assets to offset the negative margin problem and to cover operating expenses. On a very preliminary global basis it appears that the Companies require an injection of capital and/or earning assets in the order of magnitude of $150 to $200 million in order to have an opportunity to continue their operations on a potentially viable basis.
>
> The Companies have prepared five year projections of their financial statements and cash flows under various sets of assumptions. We have had an opportunity to perform only a cursory review of these forecasts and have had no opportunity to discuss these with officials of the Companies. It appears, however, that these forecasts acknowledge that the Companies cannot continue on a viable basis without a substantial capital injection and that such capital is not available within the group. [Exhibit 545 at 260]

In late May, 1987 the matter of allowing further investment in FIC and AIC was discussed at one or more of the regular meetings between the companies and Treasury and it was agreed that no new money would be taken into the companies, but rollovers would be permitted. [12380; 23389; 33105-6; 31839-40] Marlin initiated a memorandum dated June 2, 1987 for dispatch to the sales force which directed that:

> Until further advised all new money coming in must be taken into Principal Savings and Trust, Principal Group notes or Mutual Funds. Maturing Term Certificates in First Investors Corporation and Associated Investors of Canada can continue to be rolled over and reinvested in the same company. [Exhibit 393 at 1]

The memorandum that actually went out to the sales force was dated June 5, 1987 and read as follows:

> As an initial step towards further emphasizing mutual fund products, we will begin to offer FIC/AIC term certificates products to maturing term certificate customers only. *These clients may add new money to their rollovers.*
>
> We will continue to offer ABC plans to existing and new customers.
>
> This program takes effect immediately. [Exhibit 188] [Emphasis added.]

Marlin's evidence was that he was in hospital at the time the June 5 memorandum was dispatched and did not authorize the words "These clients may add new money to their rollovers". He testified that he did not notice this difference from the earlier version. [13066] There is no evidence as to how the June 5 memorandum came to be prepared and dispatched to the field in contravention of the agreement with Treasury that no new money was to be permitted to be invested in FIC and AIC. Neither Agrios or Ryan nor Treasury was aware of the June 5 memorandum. [23389-90; 23314; 31839-40; 32350-1; 33105-6]

At a subsequent meeting, Kalke and McPherson advised Agrios that it had come to their attention that the companies were still taking in new money. [23390-1] Agrios sent a letter dated June 10, 1987 to Donald Cormie stating in part as follows:

> We wish to confirm our recent discussions relating to the new program for "potential new investment money" for FIC and AIC.
>
> We wish to confirm that a program has been instituted through the salesmen whereby there will be no new funds received from investors under the "new investors" category.
>
> In recent meetings we have been apprised that the program has not be [sic] effectively implemented and it appears the new investment program is still being made available. It is imperative that this be terminated at once as there can be no misunderstanding in regard to the undertakings that have been given. Any reoccurrences will seriously jeopardize our discussions with the British Columbia and Alberta Governments. [Exhibit 518 at 187]

The evidence shows that notwithstanding the agreement with Treasury and the advice of Agrios and Ryan to the companies, they continued to take in new money through June 30, 1987. [Exhibit 522; 23307-12]

With respect to why Treasury was prepared to permit rollovers, McPherson and Kalke testified that there were several reasons. The companies indicated that it was necessary to allow rollovers in order to put the "no new money in" process in place. There was also concern as to whether it was proper to "prefer" those investors whose certificates were maturing over those whose were not. [32348-50; 31837-8; 31846-7]

Another major meeting was held on June 3, 1987 at which time a written submission containing 8 scenarios and supporting documentation was presented by Agrios to the Alberta and British Columbia regulators. [Exhibits 258 and 300] The submission stated that FIC and AIC were not viable and proposed winding them down to maximize the return on assets while preserving the remaining companies in the Principal Group of Companies with Government financial assistance.

The submission recommended adoption of Scenario #4 or, in the alternative, Scenario #6. Scenario #4 called for the immediate repayment of all contract holders. It projected required Government funding in the amount of $386 million, although with subsequent recoveries on the disposition of assets the eventual cost to the Government was projected at $177 million. Scenario #6 involved repayment of all contract holders on the maturity dates of their certificates, with full additional credits to March 31, 1987 but 4.5% maximum additional credits thereafter to maturity. No new sales of certificates would be allowed, but existing holders would be allowed to reinvest. Scenario #6 did not involve a large initial outlay of money, but projected an eventual cost to the Government of $210 million.

The scenarios were given to Kinsman for review. Loans and Guarantees had already begun to analyze the information on FIC and AIC and other companies in the Principal Group of Companies being forwarded to Treasury from Ryan and Agrios. On an on-going basis in May and June, Loans and Guarantees prepared summary reports on the financial condition of FIC and AIC and the other companies, the reasons to provide or not provide Government assistance, the alternate courses of action open to the Government and the estimated costs of each. [Exhibit 587 at 599-605, 720-68, 807-26 and 858-82] A number of these reports were forwarded by McPherson to Johnston. [Exhibit 588 at 19-66] They indicated that deficiencies in the order of $130-160 million could result on liquidation.

On June 8, 1987 Alberta Treasury was advised by Sinclair in British Columbia that no financial support would be available from the British Columbia Government. [Exhibit 587 at 782/A]

On June 19, 1987 Kalke, as Acting Superintendent of Insurance, forwarded to McPherson Special Reports on FIC and AIC pursuant to s. 37 of the *ICA*, advising that he was satisfied that the companies did not comply with s. 8(b) and that there existed a state of affairs that was or could be prejudicial to the interests of the contract holders. Kalke recommended the immediate appointment of a receiver and manager. The Special Reports were forwarded to Johnston on June 23, 1987. [Exhibit 587 at 915A-K]

On June 22, 1987 the Priorities Committee agreed to recommend to Cabinet that the Government commence legal action to put FIC and AIC into receivership. [Exhibit 588 at 67] On June 24, 1987 Cabinet agreed with the recommendation. [Exhibit 588 at 68]

On June 30, 1987 the registration of FIC and AIC as issuers under the *ICA* was cancelled. [Exhibit 587 at 951-2]

F. AMENDMENT OF THE *ICA*

This matter arose a number of times in the 1980s, usually as a result of the findings of the annual examinations of FIC and AIC and the recommendations of the Audit Section.

It was raised by Marlin in 1980. In a letter dated September 3, 1980 to CCA Minister Koziak prompted by the U.S. depository dispute, Marlin asked for review and clarification of the method of regulating investment contract companies. He complained that FIC and AIC were being asked to comply with 3 types of regulation — the "capital ratio" method, the "assumed rate" of reserve method and the "custodian depository" method — when any one of them would be adequate. [Exhibit 478 at 109] Koziak replied to Marlin's letter by letter dated September 26, 1980. Therein there was no reference to any steps being taken to amend the *ICA* on the basis of the companies' complaint.

With respect to the 1980 annual examinations, Darwish made Martin aware of Eldridge's finding that FIC and AIC were not complying with the 25:1 ratio. He outlined for Martin the reasons for requiring a capital ratio and again recommended that the *ICA* be amended to require a capital ratio. [Exhibit 580 at 29] Martin testified that in response he began development of a legislative proposal. [30152-54] He shared the concern of Darwish and others that the $500,000 capital requirement was inadequate. [30153]

In 1983 a bill called the *Deposit Taking Companies Act* was put into draft form. [Exhibit 576 at 1725] The bill contemplated including investment contract companies within its regulatory purview and repeal of the *ICA*. It included provisions establishing minimum capital requirements; requiring CDIC coverage; restricting the power to borrow, to accept deposits and make loans and issue debt obligations; requiring reserves; and requiring disclosure in audits. Osterman testified that she was aware that this draft bill, if passed, would mean that FIC and AIC would be subject to more stringent capitalization requirements, and that the members of CCA thought that to be desirable. [31128-34]

The bill never went beyond the first draft. Osterman said that was because it was desirable to have uniform legislation across the country, and she understood that Barbara McDougall, then federal Minister of State for Finance, was doing something in that regard. [31134-7]

On at least three occasions in 1984 (January, July and September) amendments to the *ICA* were considered in order to increase capitalization requirements, establish minimum asset tests and give the Superintendent greater authority to ensure proper enforcement. [Exhibit 593 at 24-32] None were implemented. Martin understood the reason to be Osterman's concern that amendment of the *ICA* might draw attention to FIC and AIC, which could result in runs on the companies and shake public confidence in Alberta financial institutions. [30215] He understood that no legislative initiatives were taken in 1985 and 1986 for the same reason. Osterman's evidence, on the other hand, was that she did not want to make *ad hoc* amendments; she wanted to develop a comprehensive statute. She admitted, however, that nothing was done to develop such a bill. [31147-9]

Amendment of the *ICA* arose again in late 1986 after the transfer of administration from CCA to Treasury. Several draft bills were prepared but no amendments were enacted as at June 30, 1987. [Exhibit 587 at 966-1091]

Despite the perceived inadequacy of the *ICA* and the recommendations made by the Audit Section and Superintendents that the *ICA* be amended, there is no legal duty upon any government under our constitution to pass any legislation, as discussed in Appendix 5.

G. APPROVAL OF CONTRACTS AND PROMOTIONAL MATERIALS

By s. 24 of the *ICA*, all forms of investment contracts used by FIC and AIC were to be approved by the Superintendent. Pursuant to s. 25, no circular, pamphlet, brochure, specimen contract, contract application form or other document could be used by FIC, AIC or the salesmen in connection with the sale of any investment contract unless it had been approved by the Superintendent. Pursuant to s. 46 FIC, AIC and the salesmen could not make written or oral representations to the effect that the ASC or the Superintendent had in any way passed on the financial standing or solvency of the companies or on the merit of any investment contract.

Darwish testified that the purpose of this approval process was to ensure that the representations contained in the documents were accurate and not misleading. [25778-9]

I do not propose to discuss in this Report every instance where a form or document was submitted for approval by FIC or AIC. Rather, I intend to outline the general process of review and discuss specific concerns or situations where it is warranted.

The Approval Process

During the period from 1976 to 1981 or 1982 Douglas Higgins, a member of the Audit Section, was responsible for review of the companies' contract forms and advertising materials, under the supervision of Pointe. In subsequent years, other members of the Audit Section would review and comment on forms and materials as requested.

The companies would submit two copies of each document for approval. If it was acceptable, one copy would be stamped "Approved", signed, dated and returned to the companies. No written criteria for approval were developed; the regulators relied on the *ICA* and "common sense". [28436-7] The procedure Higgins established was to compare the wording of the contract or advertisement submitted for approval with that of previous documents which had been approved, and then consider whether it contained anything objectionable. Objections were documented in letters to the companies, which would be sent out after review and concurrence by Pointe. Approvals were handled in a similar manner. Higgins would draft a letter to FIC or AIC and place the approval stamp on the subject document; Pointe would sign the stamp and review the letter, after which the material was returned to the company. [27757-60]

Higgins was not involved in the desk or annual examinations of FIC and AIC and had no knowledge of the financial condition of the companies. [27792-3; 27837-8]

Higgins testified that he was unaware of any safeguards to ensure that all forms and advertising materials used by FIC and AIC were in fact approved by the Superintendent's office; to the best of his knowledge the regulators relied upon the companies to submit their documents for approval. [27764] He stated that during the period when he was responsible for reviewing advertisements, he could only recall one instance where an FIC/AIC advertisement was inserted in a newspaper without prior regulatory approval. [27765-7] Romalo testified that on occasion during the course of the annual examinations, contract forms from the companies' files were checked to see if they had been approved. [26904-5]

In a memorandum dated August 27, 1980 from Darwish to Pointe following a discussion of the companies' advertising, Darwish issued the following directive:

> As discussed today I would like to make the following our goals with respect to the above:
>
> 1. Eliminate the current reference to the "depository" as it is presently done in advertising, the application form and the addendum to the application form.
> 2. Eliminate reference to the Canadian and British Insurance Act. This should be done, if necessary, with the assistance of the Federal Superintendent of Insurance.
> 3. There should be only one sentence, in bold print, on the application form and advertising saying that deposits are not covered by the C.D.I.C.
> 4. Eliminate reference to the word "guarantee". [Exhibit 567 at 312]

By memorandum dated September 19, 1980 Pointe reported to Darwish:

> 1. On August 19, 1980 I wrote to Mr. McIsaac and Mr. Marlin (copies of letters attached) to eliminate reference to the Canadian and British Insurance Companies Act.
> 2. In a telephone conversation with Mr. John Hickey I requested that all reference to the "On Deposit", "Government Approved Custodian" and the Canadian and British Insurance Companies Act be removed from advertising literature and application forms.
> 3. I have provided the branch auditors with a copy of your memo setting out the goals of August 27, 1980.
> 4. I requested a review of the contracts and advertising to be conducted by Mr. D. Higgins (copy attached) to determine the extent of reference to the Canadian and British Insurance Companies Act. Also, on August 18, 1980 I have asked for a legal opinion of Section 41 [now Section 46] of the Investment Contracts Act.
>
> Your memorandum of August 27, 1980 will be implemented immediately in the review of contracts and advertising. [Exhibit 567 at 311]

By memorandum dated October 23, 1980 Higgins advised Pointe that the Attorney General's office was of the opinion that the contracts and advertising materials of FIC and AIC on file with CCA violated the *ICA*, and that in order to comply with Darwish's directive, he thought all contracts currently marketed by the companies would have to be revised. [Exhibit 568 at 27]

The Contract Application Form

In September, 1980 Hickey, Vice President, Marketing of PGL suggested new wording for the top left paragraph on the back of the contract application form. [Exhibit 571 at 373] In October there were several meetings among Darwish, Pointe, Higgins, Marlin and Hickey to discuss the wording of FIC and AIC contract application forms. As a result, it was agreed that use of the word "guarantee" would be eliminated from the forms; it would be made clear that additional credits were at the discretion of the directors; and, the "Terms of the Contract" on the reverse side of the form would be changed. [Exhibit 403 at 119 and 122-4] Several months thereafter, the Superintendent's office approved the use of the wording:

> First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank. Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies. THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION. [Exhibit 568 at 49-51; Exhibit 403 at 137-9]

The evidence shows that this wording continued to be used until 1984, when the Superintendent's office required another change to be made.

Pointe testified that the statement "Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank" was a representation as to the value of the assets and was reflective of the s. 8(c) test. [28494-5] He admitted that the statement was not true in 1980. At the time the statement was approved, Pointe and Darwish were in possession of the 1979 annual examination reports for FIC and AIC wherein the Audit Section reported that the companies did not satisfy the s. 8(c) test by reason of holding U.S. securities on deposit outside of Canada. [Exhibit 550 at 2-3; Exhibit 551 at 21] Pointe also admitted that the statement was not true in 1981, 1982 or 1983 according to the calculations of the Audit Section, which showed a deficiency in the s. 8(c) test in those years independent of the U.S. securities. He could not recall any discussions with Darwish, Kaiser or Saleh as to the propriety of allowing the statement to be made under those circumstances. [28499-505] Darwish raised the matter in a memorandum to Martin in 1984 [Exhibit 580 at 153], however, Martin could not recall it or what was said on the contract application form. [30258-9]

Hutchison testified that he discussed the statement "Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank" with Eldridge and Darwish. He said that they did not believe the representation to be accurate in light of the Audit Section's calculation of a $72 million shortfall in the value of the mortgage and real property assets by the summer of 1984. [26484-5]

Eldridge's evidence was similar. He testified as follows:

> Q You felt that that was inaccurate, that representation that was being contained in the material, correct?
>
> A Yes.
>
> Q The reason you felt it was inaccurate was because by the summer of 1984, you had already determined that there were capital deficiencies of in excess of $80 million for FIC alone, correct?
>
> A Yes, we — I felt that it was inaccurate in that the real estate valuation problem existed, and if that wasn't resolved by putting in additional capital, then there is a definite shortfall.
>
> Q Well, not only was it the real estate problem that was the difficulty, before you even encountered that problem in '84, by January the 4th — or January the 12th of 1984 when Mr. Saleh's letter went out, there was already a $35 million capital deficiency problem, ignoring the real estate problem, correct?
>
> A Yes, but I think a lot of that pertained to the U.S. securities, did it not?
>
> Q All right, approximately 21 million of 28 million. You are still talking about a capital deficiency, any way you cut it, correct?
>
> A Yes.
>
> Q For those reasons, it would be inaccurate, as far as you believed, to make those representations to the public?
>
> A Yes.
>
> Q I gather, sir, in fairness, it obviously must have concerned you to see the public being told these things and being given these representations, correct?
>
> A The statements concerned me, yes.
>
> Q They concerned you because you didn't want to see the public being misled?
>
> A I did not want to see the public misled.
>
> Q You considered those representations misleading, didn't you?
>
> A Unless the capital deficiency was resolved.
>
> Q You knew it wasn't resolved?

A I knew it wasn't resolved at that time, yes.

Q So, therefore, it was misleading?

A Yes. [27488-9]

The process resulting in the change in the wording of the form in 1984 began in July, when Rodrigues asked Eldridge to comment on the form being used by FIC and AIC. Apparently the companies could not find their record of approval and re-submitted the form for approval. [Exhibit 567 at 715] Eldridge responded by way of a memorandum dated July 27, 1984 wherein he commented, *inter alia*, as follows:

> (3) In Section A & D, Additional Credits, a reference is made that the additional credits are declared quarterly. Based on the information we have available this is not being done. Due to the following factors consideration should be given to refusing approval to the company to issue this and further certificates with additional credits.
>
> 1. The company's past action in ceasing without notice the declaration of additional credits on selected certificates.
> 2. The company's comments at recent meetings that it has the authority to cease paying additional credits to meet the requirements of the Investment Contract Act.
> 3. The company's present method of marketing certificates with additional credits.
> 4. The company's present serious financial position.
>
> (4) The form states assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian Chartered Bank. This statement should not be made as the US securities are held by a United States bank. This section also stated assets are in a type permitted to Canadian incorporated life insurance companies. Until the matter of the sale from Principal Trust to the contract companies is resolved the company should not be making this comment. The reference to the "life" type of insurance should be deleted as the Canadian and British Insurance Act does not differentiate between life and non life for the investments permitted. The reference to "life" may create an allusion to quality of security as it is said no Canadian premium payer has ever lost money in a life insurance company but has in a non life company.
>
> (5) As this document forms part of the certificate the following is missing
>
> (a) The reserve rate is not stated (Section 30(b) of the Investment Contract Act). The company uses 6% and this amount should be stated in the contract.
>
> (b) The definition of an investment contract states cash surrender or loan values must be included in the contract. This statement is not included. [Exhibit 567 at 716]

Bokhari, another member of the Audit Section, testified that he also reviewed the form and had two concerns:

1. That assets were not equal to 100% of certificate liabilities because not all of them were on deposit in Canada; and
2. That the value of the assets was not equal to 100% of certificate liabilities in any event. He did not believe the statement in the contract form to be true. [27866-9]

Thereafter, Saleh asked Bokhari to review Eldridge's memorandum. In a memorandum to Saleh dated August 21, 1984 Bokhari advised Saleh that Eldridge's item #3 should no longer be a concern in light of Marlin's July 20, 1984 letter advising that FIC and AIC were able to declare and pay additional credits for the first 3 quarters of 1984, in advance. Bokhari said that items #4 and #5 should be implemented. He recommended that the statement "Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank" be deleted. [Exhibit 569 at 9-10]

On August 30, 1984 Rodrigues sent a memorandum to Saleh following their meeting the day before to discuss the form. He confirmed that they had agreed to write to the companies outlining their concerns and had agreed on the following points:

> 1. The application form states that the company has on deposit assets equal to 100% of its liabilities with a Canadian Chartered Bank. Under the present financial circumstances we do not agree with this statement. It should be that the company is *required* to hold on deposit. In addition, the company should not compare itself to a life insurance company which falls under different legislation.
> 2. The contract does not have a cash surrender or loan value option to fulfill the criteria as an investment contract as defined.
> 3. While the Investment Contracts Act (Act) states that the assumed rate (reserve rate) be shown in the contract, it was concluded that it could possibly mislead the public. It was decided that the company determine the reserve rate for each class of contract and have the rate approved by the Superintendent when the contract is submitted for approval. It was concluded that the purpose of section 30 of the Act is for the Superintendent to regulate the reserving formula used by an issuer and not for disclosure to the contract holder. [Exhibit 569 at 12]

Bokhari testified that Saleh brought him a draft letter Saleh had prepared [Exhibit 569 at 13], and asked him to send it in Bokhari's name as Saleh was very busy. [27873-5; 27880-2] The letter, which went to FIC over Bokhari's signature on September 28, 1984 read as follows:

> Attention: Mr. A. Smith
> Legal Department
>
> Dear Mr. Smith:
>
> Re: Application Form
>
> Further to your submission of the application form to be used for the sale of investment contracts for our approval, our comments are as follows:
>
> (1) The application form should state clearly the cash surrender or loan value of the contract.
>
> (2) On the back side of the application form, it is stated that the company has on deposit, assets equal to 100% of its liabilities with a Canadian Chartered Bank. Under the present financial circumstances we do not agree with this statement. However, if you wish, a statement similar to the following may be included: "Company is required under the Investment Contracts Act to maintain funds with a Canadian Chartered Bank equal to its liabilities to the holders of its contracts.
>
> In addition to these two items, we would like you to submit Reserve Rates for each class of contract for our approval. Should you have any further questions, please do not hesitate to contact us. [Exhibit 569 at 13]

In a follow-up letter dated October 2, 1984 Bokhari advised that the phrase "Assets are in qualified investments of the type permitted to Canadian incorporated Life Insurance Companies" should also be deleted from the top left box on the back of the form. [Exhibit 569 at 17]

As a result of the September 28 and October 2, 1984 letters, the top left box on the reverse side of the contract application form was changed in October, 1984 [Exhibit 100] to read:

> I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION. Exhibit 403 at 255]

Bokhari testified that in his view the statement "Company is required under the *Investment Contracts Act* to maintain funds with a Canadian Chartered Bank equal to its liabilities to the holders of its contracts" said the same thing as the existing representation, and he thought it was misleading in view of Hutchison's 1983 annual examination report. [27910-1] He testified:

> Q At this particular point in time, September 28th, 1984, or August 1984, was it common knowledge in the office of the Superintendent of Insurance that the belief was the assets did not equal 100 percent of certificate liabilities?
>
> A I believe so. [27878]

And further:

> Q Right. But I am following up, sir, you had oral discussions with Mr. Saleh before the letter of September the 28th went out?
>
> A Right.
>
> Q And after, and you were not content with the representation that was contained in that letter of September 28th, correct?
>
> A I was not content with the wording.
>
> Q You told Mr. Saleh that, correct?
>
> A Verbally, yes.
>
> Q And verbally, what did Mr. Saleh say back to you? Why did he say, regardless of your concerns or whatever, to send out the letter?
>
> A Well, his reply was that he is going to look into it and see what he can do. That's the typical answer I got.
>
> Q Did something occur after your initial oral discussions with Mr. Saleh about sending out the letter in which he finally said, go ahead, send off the letter?
>
> A No, nothing.
>
> Q I believe I heard you indicate earlier that in your discussion with Mr. Saleh about this representation that the companies were required to maintain, you also discussed with Mr. Saleh the annual examination and the calculation of a test which reflected $130 million shortfall on the Section 8(b) test?
>
> A I might have mentioned, yes.
>
> Q What did Mr. Saleh say in response to this being brought to his attention, namely that there was a $130 million shortfall, but the public was still being told that the companies were required to maintain assets equal to liabilities?
>
> A He did not say anything very specific to that. As I said before, at that particular time when these things were happening, they were very, very busy right from the Minister to the Superintendent, and they were attending meetings left and right. You can get — you can tell, you know, the Superintendent on his way out and you will stop him for a verbal little questioning and he will say that, well, leave it with me, I am going to look into it and I will get back to you. That was the end of the story.
>
> Q That's essentially what happened in connection with your pointing out to him the $130 million shortfall and the representation. He said leave it with me?
>
> A Yes, that was the reply I always got. [27915-6]

Saleh's evidence was as follows:

> Q So you knew that your Audit Section had determined that assets were not equal to 100 percent of its liabilities, even with consideration of the U.S. deposit?
>
> A That's correct.
>
> Q Was there any discussion about completely eliminating or deleting the statement altogether?

A I think my opinion was we should at least put the requirement, the legislative requirement, because if you delete it, the person who would take it would know nothing about it. But if I put the requirement of the legislation, I would give them a flag.

Q You what?

A I will give him a flag.

Q You will give him a flag?

A A flag. The normal question would be, are they meeting this requirement or not? [29220]

And further:

Q Your view of the statement, "Company is required to maintain funds", your view of that statement was that that would not mislead an investment contract holder or a potential buyer?

A That's my view.

Q Because you say you are merely stating a statutory requirement, not representing that the statute is being complied with?

A Excuse me, not representing what?

Q That the statute is being complied with?

A That's right.

Q You say you are putting up a flag so they can inquire as to whether the statute is being complied with?

A Yes, this is a form that could be used at any time.

Q I know what it is, Mr. Saleh.

A Yes.

Q You are raising a flag that can put the investor on inquiry, is what you are saying?

A That's correct. [29223-4]

There is evidence that the Superintendent's office did not disclose to the public upon inquiry whether FIC and AIC complied with the *ICA*. [Exhibit 580 at 131-41] Both Rodrigues and Martin testified that it was CCA policy not to discuss the financial condition of the companies or disclose financial information about the companies to the public. [28040-2; 30233-4] Saleh testified that it would have been "very irresponsible" to disclose the capital deficiencies calculated by the Audit Section. [29227] He admitted that this information was not otherwise available to Alberta consumers. [29230] At the same time, Martin testified that the public might well expect the regulators to ensure compliance with the *ICA*. [30236-7]

Saleh further testified that the decision not to disclose such information was his and was not discussed with the Deputy Minister or Minister. The change of wording on the contract application form was not discussed with them either. [29227-8]

By letter dated September 5, 1985 Saleh required all application forms, contracts, circulars, pamphlets, brochures and other documents such as certificates to contain a statement in bold print warning that "Investment Contracts are not deposits and therefore are not covered by the Canada Deposit Insurance Corporation". [Exhibit 570 at 570]

By letter dated January 9, 1986 Saleh directed that the warning statement be amended to read "Investment Contracts are not insured by Canada Deposit Insurance Corporation". The statement was to be in bold print on all pamphlets, brochures and circulars and in bold print in red across the face of all applications, contracts and certificates. [Exhibit 570 at 624]

The warning statement was modified again by letter dated August 27, 1986. Saleh directed that the statement "(Name of investment contract issuer) is not a member institution of the Canadian Deposit Insurance Corporation (CDIC) and investment contracts and/or certificates are not insured by CDIC" be in bold print on all application forms, specimen contracts, circulars, pamphlets, brochures or other documents to be used by issuers or their salesmen in connection with the sale of investment contracts. [Exhibit 570 at 627]

Brochures

A similar representation to the effect that sufficient assets were on deposit was made in a FIC and AIC term certificate brochure. [Exhibit 113] The brochure, which was dated "03/80" and was in use until 1985, stated:

> **FEATURE: Safety**
>
> **BENEFITS: Your money is fully guaranteed.**
>
> DETAILS: First Investors Corporation Ltd. or Associated Investors of Canada Ltd. guarantee your principal and interest.
>
> Assets equal to 100% of certificate liabilities are maintained on deposit with a government approved custodian. Assets are invested in securities and mortgages which qualify under the Canadian and British Insurance Companies Acts, the same regulations that govern Canadian life insurance companies. Since investment contract companies like First and Associated and life insurance companies do not accept demand deposits their products are not covered by the provisions of the Canada Deposit Insurance Corporation.

Darwish testified that he was not aware of this brochure. [25815-6] Higgins testified that he could not recall approving it. [27774-5]

The evidence shows that the wording of the brochure was not changed until the summer of 1985. By letter dated June 14, 1985 PGL forwarded to Bokhari for review and approval a proposed "Principal Term Certificates" brochure with respect to FIC and AIC term certificates. Bokhari was advised that the brochure would be used, *inter alia*, as a handout by salesmen. [Exhibit 576 at 1006] It contained the statement "Assets equal to 100% of certificate liabilities must be maintained on deposit with a government approved custodian."

Eldridge was asked to review and comment on the brochure. He suggested a number of changes, including deletion of "safety" and "safe" in reference to the certificates, deletion of "guaranteed" unless the guarantor was named, deletion of the statement that since investment contract companies did not take demand deposits they did not require the protection of CDIC and distinguishing between fixed and additional credits. He expressed concern about the reference that assets were invested in securities which qualified under the *CBICA* in view of the companies' investment in AHL. He did not comment on the above referenced statement. In testimony, he did not know why he did not do so. [27498]

Most, but not all, of these items were changed. However, Eldridge also recommended that the brochure not be approved until the outstanding matters between CCA and the companies were resolved. That recommendation was not followed; the brochure was approved by Saleh with the proviso that it state that the certificates were not covered by CDIC. [Exhibit 567 at 949-62]

Proposed Investigation into Sales Practices

On May 10, 1984 Darwish sent a memorandum to George Blochert, the Executive Director of Regional Services within CCA and the individual responsible for consumer investigations, with respect to a telephone inquiry to PS&T regarding interest rates. [25508-13] The memorandum, which was copied to Saleh and Pointe, said:

> Al Hutchison showed me a copy of a schedule of interest rates for trust companies that appeared in today's Edmonton Sun and included with the trust companies was "Principal Group". We were unsure if the interest rates quoted were those of Principal Trust or those of the investment contract companies and so I phoned Principal Trust — who have the same phone number as all of the Principal Group. I asked for the interest rates of the trust company and was quoted rates a quarter per cent higher than those appearing in the paper. I asked if those were the trust company rates and the person I was talking to on the phone (sounded like a young man) told me that those were the rates for First Investors. He asked me if I knew the difference between First Investors and the trust company and I said no. He told me that First Investors was like an insurance company. I then asked him what the interest rates were for the trust company and he quoted me rates that were the same as those appearing in the paper — which were a quarter per cent lower than the First Investors rates.
>
> I asked him why the trust company rates were lower than the investment contract company rates and he told me that with the trust company, you get C.D.I.C. coverage and you have to pay the insurance on that yourself and that is why your return is a quarter per cent less.
>
> I said to him, I suppose a person should pay the quarter of a per cent in order to get the insurance. He said if you think that First Investors is going to go bankrupt, then you should invest in the trust company. He went on to say that First Investors is 100% secure — that it is secured the same as any insurance company. He said that all the assets are deposited with the Royal Bank and that if First Investors had problems, the Royal Bank would pay me out. He said the Royal Bank is the trustee for all the money — if there was a problem, they take over and distribute out the money.
>
> He said that the First Investors money is not 100% secured but it's insured, while the trust company money is 100% secured — unless you had a million dollars to invest and then you are secured only to $60,000 and in that case, you should put your money in First Investors to get the extra quarter per cent. [Exhibit 552 at 898]

In turn, Blochert sent a copy of the memorandum to all Regional Directors and directed the Edmonton Regional Office to investigate the type of information being given out by FIC, AIC and PS&T. [Exhibit 552 at 912] Of major concern were the following statements made by the salesman:

> "First Investors was like an insurance company."
>
> "First Investors is 100% secure — that it is secured the same as an insurance company."
>
> "all the assets are deposited with the Royal Bank and that if First Investors had problems, the Royal Bank would pay me out"
>
> "the Royal Bank is the trustee for all the money — if there was a problem, they take over and distribute out the money"
>
> "First Investors money is not 100% secured but it's insured, while the trust company money is 100% secured — unless you had a million dollars to invest and then you are secured to $60,000"

That same day, Martin countermanded Blochert's directive. By memorandum to him dated May 16, 1984, and copied to Darwish, Saleh and Pointe, Martin advised that:

> It has just come to my attention that inquiries are going to be initiated at the regional level into the sales practices of the above companies [PS&T, FIC and AIC]. Inasmuch as the financial status of these companies is now receiving my attention, and that of the Minister, I would request that your instructions of May 16, 1984 be immediately withdrawn and that no further action be taken on this matter unless under my specific instructions. [Exhibit 552 at 917]

No investigation was ever done.

Darwish testified that he did not go to Martin or discuss with him why the investigation was cancelled. [25515] Saleh testified that the decision was the result of a discussion he had with Martin. He said that because the complaint came from a member of CCA rather than the public, in his opinion a "full-blown investigation" was not warranted. Instead he took the matter up with Marlin, who told him he would do all he could to prevent a recurrence. Saleh did not know what Martin meant by the phrase "Inasmuch as the financial status of these companies is now receiving my attention and that of the Minister". [29143-5]

Martin testified that upon Saleh bringing the matter to his attention he took immediate action without reference to the Minister. He cancelled the investigation, with Saleh's agreement, because it could potentially focus public attention on the companies and erode public confidence in them. [30269-78] He testified:

> Q How did you deal with the fact that, perhaps, there may be some improper sales practices going on?
>
> A I guess — no, I didn't deal with that fact, counsel. [30275]
>
> And further:
>
> THE INSPECTOR:
>
> . . . You didn't want to find out whether that was, in fact, happening in all of the offices?
>
> A I didn't want an investigation to occur at this time, Mr. Code.
>
> THE INSPECTOR:
>
> Because by investigating improper sales practices, you might bring down the whole company?
>
> A I wasn't sure where it would lead, but I wasn't prepared to take that risk.
>
> THE INSPECTOR:
>
> I see. So what consideration was given to the future purchasers in that decision?
>
> A Well, I don't think I gave any consideration in making the decision to future purchasers. I was more concerned about the ongoing existence of the company. [30279-80]

Martin stated that after the fact he told Osterman what he had done and she agreed with his decision. [30276]

Annual Reports and Annual Review

The Annual Reports of PGL and the 1985 Annual Review were not submitted to the Superintendent for approval. Yet there is evidence that the regulators were concerned that such documents could be used to sell investment contracts. In his 1984 annual examination reports dated September 6, 1985 Romalo stated that "I have serious concerns about F.I.C. and A.I.C. using the PGL annual report as promotional material for prospective customers of investment contracts. This annual report has never been presented to us for approval as promotional material". [Exhibit 550 at 323; Exhibit 551 at 466] Romalo testified, however, that he was not aware whether, in fact, Annual Reports were being used to sell investment contracts. [26906]

Eldridge testified that the Audit Section knew of no specific instances of the Annual Reports being used as promotional materials. However, he said they were lying in Principal offices where customers could pick them up. That was how the Audit Section acquired copies. [27500-1]

Romalo could not recall any follow-up with respect to his concerns. [26719-20] There is no evidence of any action being taken by the Superintendent or CCA with respect to the use of PGL Annual Reports in the sale of FIC and AIC investment contracts.

The evidence shows that by late 1986 Alberta Treasury was aware of the existence of the 1985 Annual Review [Exhibit 11] and was concerned about its accuracy. By memorandum dated November 19, 1986 Visman advised Pointe that in her opinion the Annual Review was materially misleading. [Exhibit 571 at 1376] That view was conveyed to Johnston in a memorandum dated December 18, 1986 from McPherson which read as follows:

> We recently obtained a copy of a printed Review on Principal Group Ltd., and we thought you may wish to have a copy (attached) and our general observations.
>
> The Review appears to be in place of an Annual Report, usually issued by a company. Also, it makes no reference to the company auditors, Deloitte Haskins & Sells. We do not believe that this was an oversight.
>
> The consolidated net income of $607,000 mentioned in the Highlights of the Year, page 6, is the same net income reported in the audited non-consolidated financial statements of Principal Group Ltd. The auditors report on these financial statements was qualified as to an over value of owned property and property securing certain mortgages in certain subsidiaries amounting to $11,584,682. The subsidiaries in question were Associated Investors of Canada Ltd. and First Investors Corporation Ltd. The effect of the auditors qualification on the figures presented in the Review is to reverse the reported net income of $607,000 to a loss of $10,977,682, more than double the loss reported in any of the ten previous years. Shareholders equity of $23,410,000 is reduced to $11,825,318.
>
> We are advised that the company does not agree with the auditors conclusions and regards the decline in value as temporary. However, the failure to disclose these facts makes the Review, in our view, materially misleading. As you are aware, we are proceeding with the review of the financial status of Associated Investors of Canada Ltd. and First Investors Corporation Ltd. We should be in a position to advise you early in the new year on any further action we may recommend respecting the two companies. [Exhibit 587 at 245C]

The evidence shows that Alberta Treasury took no action with respect to the 1985 Annual Review, notwithstanding the belief that it was materially misleading. According to Kalke, it did not occur to Alberta Treasury that members of the public might rely on the Annual Review. [31750] McPherson also testified that it did not cross his mind that the Annual Review might be used to sell investment contracts; he took it as an indication of how PGL was doing business, which was why the memorandum was sent to Johnston. He said that no action was taken with respect to the Annual Review, however, he believed that Treasury would have a resolution of the companies' situation very early in the new year. He did not discuss the Annual Review or his memorandum with Johnston. [32299-304] Johnston testified that the Annual Review was a factor considered by Treasury in evaluating FIC and AIC. [33240-1]

H. CONCLUSIONS

1. Effect of the Regulation of FIC and AIC on the Reasons for their Financial Failure

In considering the regulation of FIC and AIC in the 1980s, I am struck by both the inability and the unwillingness of the regulators to ensure that the companies observed appropriate financial safeguards for the protection of investment contract holders and prospective investors. In my opinion, the evidence tends to show that this inability and unwillingness are integral to an understanding of the reasons for the financial failure of FIC and AIC.

The inability resulted from the regulation of the companies under the *ICA* when the vast majority of the certificates they sold were not "investment contracts" and the lack of effective financial safeguards in the *ICA* to deal with such certificates.

The evidence shows that CCA was aware from the late 1970s that a significant change in the type of products sold by FIC and AIC had taken place, and that most of the certificates sold by the companies were single pay certificates, which I have found not to be "investment contracts" as defined in the *ICA*. The evidence shows that CCA was aware that the regulation of the sale of such certificates required application of a capital ratio and larger capital base requirements than provided in the *ICA*. Indeed, it was that awareness that prompted the repeated recommendations by the Audit Section and various Superintendents for amendment of the *ICA*.

In the absence of statutory requirements which could be applied to the sale of such certificates, CCA attempted to obtain the agreement of FIC and AIC to adhere to certain requirements, including a 25:1 capital ratio, mortgage guidelines and prior approval of intercorporate transactions. When the companies failed to abide by the agreements, the regulators had no means by which to enforce compliance.

The evidence tends to show that had the sale of single pay certificates and the contract application forms not been approved by the regulators, FIC and AIC would have had to: (1) discontinue their sale, (2) obtain approval elsewhere, such as the ASC where proper safeguards could have been required, or (3) seek amendment of the *ICA* to include such certificates with the appropriate safeguards.

In the result, FIC and AIC were able to sell single pay term certificates in competition with trust companies and banks selling GICs, but without having to adhere to any comparable capital base and capital ratio requirements. I find that the evidence tends to show that this was a major reason for the financial failure of FIC and AIC.

The regulators' unwillingness is apparent from their lack of action once they knew the companies were no longer viable and, while not a cause of the failure on June 30, 1987, was a reason for the failure on that date, when the failure was recognized earlier by the regulators but not acted upon.

The evidence tends to show that CCA recognized by the summer of 1984 that FIC and AIC were no longer viable. Hutchison testified that his annual examination reports showed that FIC and AIC were technically insolvent as at December 31, 1983 although they were able to continue operating by using new money to pay maturing liabilities. In his opinion, the companies were headed for disaster and he could not understand why no action was being taken. [26480-1; 26490; 26641] Eldridge shared that view. [27423-5] Darwish held a similar opinion; he believed that it was clear by the summer of 1984 that FIC and AIC were headed for liquidation or bankruptcy unless capital in the magnitude of $72 million was injected. [25909-12]

At that time the regulators were advised that PGL, historically the source of capital for FIC and AIC, was not prepared to put additional capital into the companies. It follows that there existed a state of affairs that was prejudicial to the interests of the investment contract holders. FIC and AIC could not satisfy the s. 8 tests, yet were continuing to sell investment contracts, contrary to s. 31 of the *ICA*. The evidence shows that the regulators allowed FIC and AIC to continue to operate when there was no hope of recovery.

The foregoing conclusion is consistent with the evidence of Barefoot, who testified as follows:

> Q All right. When, in your opinion, would you have pulled the licences of these companies?
>
> A In my opinion?
>
> Q Yes.
>
> A Certainly no later than after the Hutchison annual exam.
>
> Q And what point in time specifically is that, I'm sorry.
>
> A I believe that was the 1984 audit.
>
> Q You would have pulled their licences in 1984?
>
> A Certainly no later than that.

Q Okay. And can you tell me, sir, what would be the basis, I believe you mentioned the Hutchison exam. Can you tell me specifically the basis on which you form your opinion in that regard?

A The serious deterioration of the portfolio at that point in time, if there would have been a detailed cash flow analysis in terms of the companies' ability to ever work itself out of that cash flow problem, at that point in time, I believe would have demonstrated that without significant capital injections from someone, whether it be the government or some recovery plan, or from one of the parent corporations would have been clear, at that point, that this company wasn't viable, or recoverable.

Q Is what you are telling me, sir, that in 1984, in your view, there was no prospect of recovery or there was some prospect of recovery?

A The only prospect of recovery, at that point, would have been through some bail-out proposal.

Q And so in your view, absent that, and by 1984 there would have been — the companies essentially would not have been viable, is that what you are telling me?

A No later than.

Q What do you mean by no later than?

A Could have been earlier, but I don't know for sure. [36846-7]

It is also consistent with the evidence of Allan, as follows:

Q So I take it that you determined and formed the opinion that AIC and FIC were insolvent at the end of 1983 or sometime in 1984?

A Yes, based on the financial statements of AIC and FIC, we say thay are insolvent, again on an asset test basis at the end of 1983. [36121]

An asset test basis meant that the liabilities exceeded the assets. [36119-20]

Allan further testified:

Q In your opinion, were these group of companies, that is PGL and AIC, FIC viable entities in 1985 and 1986?

A No, I don't believe they were. [36230]

Allan testified that in his opinion, using the asset test basis, PGL was insolvent by the end of 1984 and possibly in 1983 as well. [36118-20]

2. Conduct of Those Persons Involved in the Regulation of FIC and AIC

From my review of the provisions of the *ICA*, I have concluded that the statute was intended to be for the protection of the public, both existing and prospective investment contract holders.

It is settled law that public authorities must act in accordance with the objects and intent of their empowering statute: See Appendix 5 considering the Duties of Public Authorities.

It follows that the various public officials concerned with the regulation of FIC and AIC were to carry out their duties and responsibilities in furtherance of the purpose and objects of the *ICA*.

(a) Audit Section

According to the job description tendered as Exhibit 561, the key functions of the auditors were to conduct "complex" examinations of the financial institutions licenced under those statutes administered by CCA to determine if the statutes had been violated and bring violations to the attention of the senior auditor or Director of Audits through reports and supporting documentation.

In turn, the job description of the Director of Audits provided:

> This is a senior management position directing an Audit unit providing financial expertise and professional audit services to the various programs of the Department to ensure compliance with Acts, to keep the Minister and department informed of financial problems, to protect investors, and to recommend and implement action. [Exhibit 560]

In carrying out those duties with respect to FIC and AIC, members of the Audit Section believed they and CCA were responsible for protecting investors. Hutchison testified that he understood his job was to review the financial information on FIC and AIC on behalf of or from the point of view of investors. [26428] Romalo testified that his most important role as an auditor was to protect investors [26871] and that the Superintendent of Insurance and later Alberta Treasury acted as a watchdog for the public and investors. [26872] He also agreed that the investing public were entitled to rely on the proper and adequate administration of the *ICA* [26877] and that the fact of licencing FIC and AIC was an indication to the public that they complied with the *ICA*. Eldridge testified that he understood his job to be to report on the companies to the Superintendent to see if they were meeting the requirements of the *ICA*. [27722-3]

The Audit Section carried out desk and field examinations on a regular basis and performed the calculations required under s. 8. The results of such examinations and calculations were documented in reports which were reviewed and approved by the Director of Audits and thereafter forwarded to the Superintendent of Insurance, usually with a recommendation as to a course of action. The Audit Section also assisted in the drafting of the various compliance letters and reports prepared from time to time for the Deputy Minister or Minister. In the 1980s the Superintendents of Insurance were aware of the financial condition of FIC and AIC as determined by the Audit Section and the concerns and recommendations of the Audit Section with respect thereto.

The evidence tends to show that largely as a result of the examinations conducted by the Audit Section, the Superintendent by 1984 knew or ought to have known, *inter alia*, the following:

1. That there had been a significant shift in the type of product being sold by FIC and AIC from accumulation plans to single pay certificates;
2. That the Attorney General's office was of the opinion that single pay certificates were not "investment contracts" within the meaning of the *ICA*;
3. That as a result of the shift to single pay certificates, FIC and AIC were operating in a similar fashion to trust companies, but without CDIC coverage and without any similar capital base or capital ratio requirements;
4. That the Audit Section recommended that the *ICA* be amended to require a capital ratio;
5. That FIC and AIC were not adhering to the 25:1 ratio as they had agreed to do;
6. That FIC and AIC were not complying with the federal Department of Insurance mortgage guidelines which the companies had been advised would be applied to them;
7. That FIC and AIC were recording reserves at the approved maximum reserve accumulation rate (6%) rather than at the fixed rate on the face of the certificates (4%) resulting, according to the Audit Section, in a deficiency in reserves;
8. That FIC and AIC rarely satisfied the requirements of any of the s. 8 tests, according to the Audit Section;
9. That the Audit Section recommended the introduction of permanent capital to replace subordinated notes;
10. That a substantial portion of the mortgages held by FIC and AIC were in arrears and the companies had acquired a significant amount of real estate through foreclosure;

11. That FIC and AIC were experiencing recurring operating losses and were "playing accounting games" to make the books look better;
12. That the Audit Section believed appraisals were necessary in order to determine the value of the mortgages and real estate held by FIC and AIC;
13. That on the basis of the appraisals done, the Audit Section estimated the shortfall in the value of the mortgages and real estate held by FIC and AIC to be $72 million in May of 1984;
14. That in the opinion of the Audit Section, Transaction #1 was prejudicial to the interests of the contract holders;
15. That as at August of 1984 the Audit Section was of the opinion that FIC and AIC were virtually insolvent and were using new deposits to pay maturing liabilities;
16. That senior management had indicated that PGL was not prepared to inject capital into FIC and AIC; and,
17. That in the opinion of the Audit Section, FIC and AIC were entering into intercorporate transactions which were prejudicial to the interests of the contract holders.

Subsequently, the Superintendent also knew or ought to have known, *inter alia*:

18. That by late 1985 PGL was not in a position to inject capital into the companies and was itself in a precarious financial condition;
19. That by late 1985 the Audit Section was of the opinion that the companies' investment in AHL shares was prohibited under the *CBICA* and thus under the *ICA*;
20. That in 1985 and 1986 FIC and AIC were entering into other transactions which the Audit Section believed may be prohibited under the *ICA*; and,
21. That the 1985 audited financial statements of the companies were qualified.

Eldridge testified that once the Audit Section had rendered its reports and made its recommendations, it was the responsibility of the Superintendent to implement the recommendations or take action with respect to the companies. He said he got very little feedback from Saleh as to what was being done in respect of the Audit Section's reports. [27153-5] Romalo also testified to a sense of frustration with the slowness of action or inaction on the part of senior CCA officials in response to the Audit Section's work. [26825-6] Hutchison was more blunt:

> . . . what I did is during my employment there, I have indicated to the Minister through my auditors, that, you know, they are having serious problems, that something should be done about it. As you can see, for two years I wrote memos and banged my head against the wall trying to get the public aware of this, and nothing happened. So I took it on my own to advise certain clients to pull their money out. [26456]

To Hutchison's knowledge, the only things being done by CCA to ensure compliance with the *ICA* were meetings with and letters to the senior management of FIC and AIC. He was unaware of any deadlines ever being set for compliance, failing which their licences would be suspended or cancelled. [26423]

I find that the evidence tends to show that the members of the Audit Section acted with commendable zeal in carrying out their examination and reporting duties. The lack of action by the regulators can in no way be attributed to the conduct of the members of the Audit Section.

(b) Superintendent of Insurance

From 1973 the Superintendent of Insurance was responsible for the registration of investment contract companies, although from the summer of 1986 that function was in fact assumed by Alberta Treasury.

Saleh, the Superintendent as at the summer of 1984, believed his job was to protect the investing public. In a job description he prepared, Saleh described the position of Superintendent of Insurance as follows:

> The Superintendent of Insurance has direct responsibility for the regulation and supervision of both the insurance and the investment contract industries within the Province. In carrying out this responsibility he ensures proper application and enforcement of the Insurance Act and regulations and the Investment Contracts Act and regulations.
>
> The Superintendent is responsible for formulating and implementing policies plans and procedures in the following areas:
>
> • • • • •
>
> (b) Licensing of insurance corporations and registration of investment contract companies.
>
> (c) Financial examination of insurance corporations and investment contract companies to ensure that they are financially solvent and soundly managed and that they will be able to meet their obligations as they arise.
>
> (d) Disciplinary measures for non compliance with legislation including refusal, suspension or cancellation of licence where required. [Exhibit 576 at 9]

At the same time, Saleh summarized his dual role of Executive Director of Financial Institutions and Superintendent of Insurance as follows:

> Responsible for the overall regulation and supervision of the Province's financial institutions having total assets of approximately $8. Billion. The position formulates, implements and administers Divisional Policy and procedures designed to maintain confidence in and the stability of financial institutions and to protect and safeguard consumers' interests. [Exhibit 576 at 6]

Saleh testified that as Superintendent of Insurance he felt his duty was to protect the interests of the investors and the public. [29369-70] He took full responsibility for the promotional materials approved by his office and saw his role in approving such materials as a watchdog to ensure that the public understood the product and were given accurate information. [29636]

One of the methods available to the Superintendent to protect the interests of the public and contract holders was to ensure that FIC and AIC complied with the requirements of the *ICA*, in particular the financial requirements of s. 8.

It was evident in argument that counsel disagreed as to the proper interpretation of s. 8 of the *ICA*. That section mandates that no company shall be registered as an issuer unless each of the s. 8 tests are met. It was submitted in argument that s. 8 applied only to new registrants or only at the time of renewal of registration.

I do not accept such submissions. The word "registered" as used in s. 8 refers to the condition of being registered, which continues beyond the act of initial registration or renewal of registration. It is difficult to see how s. 8 could only apply to new registrants, since such companies would not have the reserves required by s. 8(d), because they would not then have sold any investment contracts. I find that the requirements of s. 8 apply to issuers at all times and that failure to satisfy one or more of the 3 tests means that a company can no longer be registered under the *ICA*.

It is true that other provisions of the *ICA*, namely ss. 10 and 37, appear to be inconsistent with the mandatory nature of s. 8. Those sections grant the Superintendent a discretion which would appear to encompass a situation where an issuer does not comply with any one or more of the s. 8 tests. Pursuant to s. 10, the Superintendent "may" suspend or cancel registration on any grounds that would justify refusal to grant registration or renewal thereof, or when it appears to him from an investigation, inspection or valuation that an issuer will be unable to provide for the payment of its investment contracts at maturity. Pursuant to s. 37, the Superintendent "may" make a Special Report to the Minister when he is satisfied, *inter alia*, that an issuer has failed to satisfy any one or more of the s. 8 tests. Use of the permissive "may" can be taken to imply that the Superintendent has a discretion to do nothing at all in such a case, which would conflict with the purpose of the *ICA*.

Section 31, however, confers no such discretion. It states that a registered issuer "shall not" issue investment contracts for sale in Alberta unless the issuer maintains the reserves specified in s. 30 [and required by s. 8(d)] and the deposit(s) of assets specified in s. 8(c). The evidence tends to show that this provision was largely overlooked or ignored in the regulation of FIC and AIC.

While acknowledging that the desk and annual examinations were for the purpose of monitoring the companies' compliance with the s. 8 tests, Saleh testified that he understood s. 8 to be applicable to the initial registration of new companies, with s. 7 applying to renewals. He said s. 7 was discretionary and that in any event a decision to cancel or suspend licences had to be made at the ministerial level. That was his understanding from discussions with the Deputy Minister and Minister. Saleh also said he could not threaten to cancel or suspend their licences without approval from the Minister or Deputy Minister, since he would lose his credibility by threatening and then failing to act. [29180-6]

Saleh testified as follows:

> Q Now, sir, who told you that you didn't have the authority to pull the licences?
>
> A Not in these words, sir. Not in these words. I asked for direction from the Minister. Here is the serious situation. I want an independent examiner in order to determine whether we continue to licence these people or not.
>
> I didn't go to the Minister and say, I want to pull the licence now, and she said, no, don't pull the licence. That didn't happen.
>
> Q Well, sir, did anyone ever tell you that you didn't have authority to pull the licences?
>
> A That's right, that was the understanding of the policy in general; that such a decision at that magnitude has to be made with the approval of the Minister.
>
> Q How did you come to that understanding?
>
> A From my discussions with the Minister and the Deputy Minister.
>
> Q So they told you that?
>
> A They told me that, yes.
>
> Q They told you that you didn't have the authority to pull the licences?
>
> A Not in these words, sir. I don't know the exact words how it happened, but that's the bulk of the discussion.
>
> I can't tell you exactly what the Minister told me in her words.
>
> Q Well, sir, I'm going to be called upon, I understand, to examine Mr. Martin next week.
>
> A That's right.

Q What I want to know is specifically this: Did Mr. Barry Martin ever expressly tell you that you did not have the authority to pull the licences?

A It could have come in our discussion that we shouldn't pull the licence, we shouldn't put the company down now, we should wait. That's how it came.

Q So he didn't tell you that?

A He told me that in different words, not in your words.

Q He told you that you should work with the company?

A That's right.

Q And put pressure on the company?

A That's right.

Q But allow them to continue to operate?

A That's right.

Q Did the Minister, that is, did Mrs. Connie Osterman ever tell you that you did not have the authority to pull the licences?

A The same way like happened with the Deputy Minister. We were the three of us sitting and discussing these matters.

Q Same conversations?

A That's correct.

Q She told you to keep putting pressure on the companies?

A Both of them.

Q To keep making demands for capital?

A That's right.

Q But to allow them to continue to operate and continue to sell?

A That's correct.

Q Did they tell you, sir, that they thought it was better to let the companies continue in operation than to pull the licences?

A Well, under these circumstances that it might, you know, affect the other financial institutions because of the depression in the real estate market, because of all these things.

Q Did you feel, sir, that in allowing the companies to continue to keep their licences, you were protecting the investment contract holders?

A In allowing — would you please repeat your question?

Q In allowing the companies to keep their licences, did you feel you were protecting the investment contract holders?

A I personally?

Q Yes, sir.

A I don't think that that was enough protection because what I wanted, I wanted to act on that, but first I wanted an independent examination to tell me exactly where do I stand. So I was in a hazy position. [30047-50]

Martin's evidence was similar:

THE INSPECTOR:

> You say Mr. Saleh was exercising discretion. You mean he had the discretion under the Act which was exercised by you and the Minister?

A Yes, I understand —

THE INSPECTOR:

> Did he do it, or were you and the Minister saying, you do it?

A Well, we used to discuss — Mr. Saleh and the Minister and I used to meet regularly in, what I used earlier, in a collegial sort of way, and we would discuss matters back and forth. Finally a conclusion would be reached, and that would be the decision that Mr. Saleh would take.

THE INSPECTOR:

> Yes, right. But it was after consultation by him with you and the Minister?

A That was the usual practice.

THE INSPECTOR:

> Let's give them some time, and then he would exercise his discretion based on that instruction?

A The question of time was always a factor, to continue to extend time to them to see if they could do a work-out.

THE INSPECTOR:

> Therefore, use your discretion to keep them licenced?

A That's correct, sir.

Q MR. WITTMANN: I think the thrust of Mr. Saleh's evidence goes further, in that he says he would never exercise a threat to cancel or suspend to licence without a direction from you or the Minister.

A That's correct.

Q Do you agree with that?

A Pardon?

Q Do you agree with that?

A Absolutely.

Q That seemed to be perfectly clear on this. That's in the sense that it's your decision, not his?

A I think even further, counsel, I think it's the Minister's decision.

Q Fair enough, but as opposed to Mr. Saleh's decision?

A That's correct.

Q That's how it worked in practice?

A That's how it would work in practice, yes. [30225-6]

It is clear that by 1984 Saleh was concerned about FIC and AIC, as evidenced by his requests for further appraisals and engagement of an independent consultant to do an assessment of the companies. He testified:

> Q Yes. I take it at that time, by the summer of 1984, Mr. Saleh, that you had determined in your own mind — and I am trying to distinguish that from policy or what someone was directing you — that there was a state of affairs in the company which was prejudicial to the contract holders?
>
> A Yes. [29598-9]

In the fall of 1984, Saleh asked Bercov to provide a legal opinion as to the authority of the Superintendent under the *ICA* to deal with the capital impairment of FIC and AIC. Bercov replied in a letter dated October 24, 1984. [Exhibit 576 at 752] He advised Saleh that the Superintendent had a discretion under ss. 10, 37 and 40 and that while the Superintendent had no express power to order an injection of capital, he could indicate to the companies that unless an appropriate injection of capital was made he would exercise that discretion.

Saleh did not suspend or cancel the companies' licences, nor make a Special Report. I take from his evidence that he did not do so because of his understanding, from discussions with Martin and Osterman, that he was to continue to work with FIC and AIC and give them time to attempt to work out their problems.

With respect to s. 31, Saleh testified that he understood the section prohibited the sale of investment contracts in Alberta unless the deposit requirements of s. 8(c) and the reserve requirements of s. 30 were met. Saleh agreed that according to the Audit Section's calculations FIC and AIC did not meet these requirements, certainly from 1984 onwards, but said they were permitted to continue selling their products because of the dispute with them over whether they met the requirements and because of CCA policy. [29507-9]

As mentioned, Saleh testified that after receipt of the qualified 1985 audited financial statements in 1986 he believed there could no longer be any valid dispute over whether FIC and AIC met the requirements of the *ICA*. He testified as follows:

> Q MR. GREENAN: So what I'm saying, though, sir, is at that point, there's really little argument, as far as you're concerned. You, at that point, are still faced with the statutory requirements and it states under Section 31, the companies shall not issue investment contracts for sale in Alberta if they don't meet the deposit requirement?
>
> A That's correct, as about July '86.
>
> Q So, indeed, in effect, every day you're allowing them to sell investment contracts to the public, they're doing so on the basis that you know they don't meet the test that they're required to meet under Section 31?
>
> A Yes, but this was referred to my Minister.
>
> Q All right, so —
>
> A We're talking about July '86 when the Treasury Department were the actual authority in that, not me.
>
> Q In fairness to you, sir, by that point, it was referred to the Minister. You're not making the decision, the Minister is making the decision?
>
> A Correct. [29511-2]

The evidence tends to show that Saleh did not fulfill his duty to administer and enforce compliance with the *ICA*. It would be unrealistic to expect, however, that Saleh would have suspended or cancelled the companies' licences without the support and approval of the Minister. He did not receive that support or approval from Osterman. Instead, he was directed to work with FIC and AIC to see if their problems could be worked out, although neither the companies nor CCA had a workout plan. Saleh had no power to threaten to suspend or cancel the companies' licences. In effect, he was not allowed to enforce the *ICA*. The most he could do was make requests of FIC and AIC, such as for the injection of additional capital, without having the means to take action if they refused. He was put in an impossible situation. In all of the circumstances, the evidence tends to show that his conduct in this regard was neither dishonest or fraudulent.

I feel compelled, however, to comment on the 1984 change in the wording of the top left paragraph on the back of the contract application form. The change was made at Saleh's instance, without direction from Martin or Osterman. I find that the change in the wording was so technical and subtle as to be no change at all and did not remedy or have any effect on the representation being made to investors and the public as to the assets of the companies and their ability to pay their certificate liabilities.

Saleh knew that the representation being made to investors in FIC and AIC was that assets on deposit were equal to 100% of certificate liabilities. He knew that the representation was or could be relied on by investors and he knew it to be false. The evidence tends to show that his conduct in requiring the change in wording was dishonest. In so finding, I am not unmindful that the failure to regulate and require compliance with the *ICA* was the result of a policy pursued by the Minister, Osterman. However, even though the policy made the regulation of FIC and AIC difficult or even impossible, it did not allow him to approve a statement known by him to be false.

(c) Minister of Consumer and Corporate Affairs

As stated earlier, the Minister was charged with the administration of the *ICA* by virtue of section 1(e) thereof.

When asked for whose benefit she believed she was administering the *ICA*, Osterman's evidence was as follows:

> Q Quite. So what did you understand the government's involvement with investment contracts to be?
>
> A To spell out the conditions under which the companies would operate.
>
> Q And as you understood it, for whose benefit was the government involved in investment contracts?
>
> A I would say that it would meet a public interest, overall. That there would be a public interest in having such legislation, in order for companies to operate. I can't say what would have been in the minds of the framers of the legislation many years ago, but obviously they believed it was in the public interest to have such opportunities available for companies, and for investors.
>
> Q I, of course, haven't troubled you with trying to see what people did years ago. I just am interested in your point of view. And in your point of view, the government's involvement with investment contracts was for whose benefit?
>
> A I hadn't thought about it as a benefit, so much as just that we were responsible for the legislation that was there. When you —
>
> Q You don't mean to conclude that you don't — that you think the government gets involved in things without a benefit in mind? You are not asking us to conclude that?
>
> A You are asking me a question that I hadn't considered in terms of legislation that I inherited. I certainly consider, in terms of legislation that I would propose, whether amendments or otherwise.
>
> Q Well, let's deal with the legislation that you were administering, all right?
>
> A M-hm, yes.

Q Did you have in mind for whose benefit you were administering the legislation? Perhaps not, perhaps the answer is no, I did not think about it?

A I did not think about it. The legislation was there, and to be maintained. [31469-70]

Osterman testified that she understood that the *ICA* contained certain capital requirements and she relied on Saleh and Martin to tell her whether FIC and AIC met those requirements. [30947] When asked about s. 31 of the *ICA*, she testified that she did not understand that FIC and AIC had to satisfy the reserve requirements in order to sell investment contracts. [31235-6]

Osterman agreed with Saleh and Martin that no threat of suspension or cancellation of the companies' licences would be made without her approval. [30950] In fact, she said:

Q The practicalities of it were that Mr. Saleh couldn't make any decision of significance regarding AIC and FIC unless he had your concurrence and the concurrence of Mr. Martin?

A Precisely. I would want to know that he was recommending and going to do a specific action that might precipitate a further action by us and by government overall. [31232]

In 1984, Saleh brought two significant matters with respect to FIC and AIC to Osterman for her approval; the obtaining of further appraisals and the engagement of an independent consultant. In his view, they were necessary in order to resolve the dispute with the companies as to whether they were in compliance with the *ICA*. Osterman refused both requests.

With respect to appraisals, she testified:

Q Let's just analyze that for one moment. Is there any suggestion that appraisals were avoided because of what they might reveal or opine?

A No.

THE INSPECTOR:

In fact you knew what they would show?

A Precisely. Precisely.

Q MR. WITTMANN: You didn't know how much in terms of money measurement they would show, did you?

A No, I did not.

Q And that measurement was necessary to determine the capital deficiency in an investment contract company. You knew that, didn't you?

A Yes.

Q So how much is the question?

A How much is the question, that's right, and would there continue to be the discussion between department officials and the company and their outside auditors about who was right.

Q Fair enough. So to get the answer to the question, the universal appraisal method was not used, it was called off, and I want to know what the alternative was as put forward by you or you and Martin, if there was one?

A Well, I expected that our officials would be working with the company officials and outside auditors to come to some consensus about the situation.

Q And was there any machinery or method put in place or discussed in the event that there would be no agreement?

A Not at that time. [30957-8]

• • • • •

THE INSPECTOR:

So then I understand that, in fact, there was no attempt to resolve this, what you had decided was the policy of your department was to let the companies go on until you determined that the real estate market came back and appraisals could help? Would that be fair?

A That's right. I wouldn't necessarily say "came back", but that the appraisals could be more reliable. [31112-3]

• • • • •

THE INSPECTOR:

I don't think it is clear. You did understand then that the only method that the Superintendent had of determining the value of property, when he didn't agree with someone else's, was to get an appraisal?

A Yes.

THE INSPECTOR:

He had no other alternatives according to the statute?

A That's right.

THE INSPECTOR:

So that if he couldn't get those kind of appraisals you knew he couldn't put a value on it at all, didn't you?

A That's right. [31339]

With respect to an independent consultant, Osterman testified:

Q This goes to Mr. Martin's evidence is that it was a factor in the deliberations as to whether or not to bring in an outside firm of chartered accountants for an overall assessment, that by doing so that would necessarily focus public attention on the investigation or assessment with the fear that that may cause a run?

A That's right, and in my view it would have been premature because I had not formulated options.

Q Okay. But premature or not, was the idea of focusing public attention part of the reason why you didn't do it at this time?

A I think we're both saying the same thing.

Q I'm not saying anything. I'm just trying to ask you —

A I thought you were.

Q Well, pardon me. I'm asking you whether that was part of the consideration in the decision not to call in outside professional chartered accountants, the fact that that may draw attention to this institution?

A Partially.

Q So it could — it was a factor?

A It could be, yes. I won't say could be, it was. There was some consideration, and it was to do with timing. [30997-8]

And further:

> Q Did you in any way — I put to you you did in some way communicate to Mr. Saleh, and incidentally, to Mr. Martin, that through 1984, 1985 and into 1986, Saleh was not to obtain an independent consultant because to do so would focus the attention of the public on these companies. You communicated that to him somehow; is that right?
>
> A Yes, very, very possible. [31515]

I find that the evidence tends to show that further appraisals were not done and an independent consultant was not engaged at the direction of Osterman, and in furtherance of a policy within CCA to give FIC and AIC time to work out their problems. Osterman described the policy, which I find was her policy, derived from her perception of a general Government desire to preserve Alberta-based financial institutions and public confidence in them, as follows:

> Q Now, there's also been evidence given, and I believe it starts in about this time frame, that Mr. Martin's perception of the government policy was to allow the companies time, that phrase has been used. It's been used in the context of time to work it out, but working it out meaning no government assistance, just the passage of time, perhaps the real estate market will come back. I think I'm fairly summarizing the evidence given. We're interested in whether you, verbally or in writing, for that matter, which we haven't seen, ever enunciated such a policy directive to any of your staff?
>
> A No.
>
> Q Was there such a policy?
>
> A Oh, I think that our policy really addressed the situation institution by institution. The overall objective of government clearly has been over time for many, many years and our administration, as I understand it, really didn't operate differently and I didn't sense that it was different at the time that I was there, and that was to try to develop and maintain good financial institutions in the province.
>
> Q Was the preservation of an Alberta financial institution then an objective, a policy objective?
>
> A Certainly if government could play a role and it was viewed that — I was working on a decision with respect to the credit unions and got that support from my colleagues sometime in 1984, and so I sensed that given a good understanding and an institution that was of critical importance to the province and, over the longer haul viable, that we would attempt to work with such an institution that we hoped would benefit all Albertans. . . .
>
> Q But with an individual institution such as the investment contract companies, when Saleh and Martin tell us that what they were getting from you was basically give them some time to work it out, that policy, if it did come from you, was specific to those two companies?
>
> A Certainly in terms of how we viewed their real estate problem, I believe time was required to see our economy settle and where it would settle, because the harm had already been done.
>
> Q When you say settle, you mean stay where it was or stabilize, stay the same for a while?
>
> A To whatever extent it settled out, it was going to be at a level that we couldn't pre determine right at that time. [31011-13]

And further:

Q That's exactly what I am interested in. What was the policy or what was the directive with respect to these two companies, AIC and FIC, in terms of giving them time?

A The time related to the stabilization in the Alberta economy and I could not predict, while looking ahead things looked somewhat better, I could not predict where the economy would be when we — when it was stabilized in our view.

Q So you were going to give them time on the expectation that there would be a stabilization of the Alberta economy; is that correct?

A That's right. I felt that the information that then would come forward on the companies would be more accurate. [31265]

Martin described the policy as follows:

Q And indeed, from '84 onward, you were aware that the companies didn't have the reserves and didn't have the deposits?

A I was aware from information received from our auditors and from Mr. Saleh that there were deficiencies.

Q So in any event somewhere the decision was made that regardless that they didn't meet the requirements of Section 31, the companies would be allowed to stay on in business?

A That's correct.

Q That was part of the policy?

A That's correct.

Q In other words, the policy, in effect, was even though under the Investment Contracts Act they were prohibited from issuing investment contracts, we take a larger view of things, the policy says, let the companies carry on and sell the contracts?

A Yes, I would agree with your characterization of the larger view.

Q That's the type of discussion, as well, that would have come up in discussions with the Minister and the task force?

A To the best of my knowledge, counsel. [30658-9]

Osterman testified that in her opinion the Alberta economy had stabilized or settled out to some extent in 1985. [31013-4] No action was taken by CCA at that time to either obtain appraisals or engage an independent consultant, notwithstanding Saleh's advice in November, 1985 that the valuation of mortgages and real estate problem had not been resolved, and her own growing concern about the companies' style of operation. [31085-6]

In fact, Osterman testified that she never had a plan of action with respect to FIC and AIC while she was Minister. [31117] She said she did not prepare a plan in 1984 because she did not feel it was necessary at the time. [31370] She testified that in late 1985 she felt that "the timing was fast approaching for development of some options for these two companies", however, that was not done due to a hiatus in administration as the result of a by-election called to enable Getty to acquire a seat in the Legislature. [31117-8; 31227-8] According to Osterman, the hiatus continued through December and January, and in February of 1986 she left the portfolio. [31231]

Martin confirmed the lack of a plan for FIC and AIC within CCA as follows:

Q I will go over it once more. There was no such plan for the investment contract companies at any time was there?

A There was no such plan.

Q All right. To develop such plans that you spent a great deal of your time working on, you would have to receive an instruction?

A That's right, that's right.

Q The instruction, in your case, would come from the Minister?

A That's right.

Q The Minister would receive the authority to work on that plan at a Cabinet level, so far as you knew?

A I can only assume that, sir.

Q All right.

A But there was no such plan. [30184]

• • • • •

THE INSPECTOR:

Yes. I mean, if we wait three years or four years for the real estate to come back to 1981 levels, can these companies survive anyway? There is no —

A We had not, to the best of my knowledge, sir, done a projection along the lines that you are suggesting.

THE INSPECTOR:

The only thing you did was, it has gone down, let's keep them going and see if by some —

A If Alberta turns around it will come back up.

THE INSPECTOR:

And with a lot of hope and prayer it will get back even?

A A hell of a lot — excuse me, a great deal of hope and prayer, sir. [30415-6]

• • • • •

Q The basis for this strategy, this policy of giving the companies time, was all predicated upon, to use your expression, a great deal of hope and prayer, correct?

A Those were my words, sir.

Q The hope was that there would be a turnaround in the economy that somehow might have an impact on improving the companies' positions?

A Yes, sir, yes.

Q Quite frankly, sir, it was a gamble, wasn't it?

A I guess it was, sir. [30653-4]

• • • • •

Q MR. DAVIDSON: Did you understand, sir, that you were taking a risk with other people's money?

A I understood that the Government of Alberta was taking a risk in permitting these companies to continue under the circumstances.

Q Did you understand they were taking a risk with other people's money?

A I understood that other people's monies were involved in this company.

Q Only other people's money?

A Pardon?

Q Only other people's money?

A Yes, the investors' money, yes. [30791]

With respect to the consideration given to prospective investors in 1984 and 1985 in adopting the policy described above, Osterman testified as follows:

THE INSPECTOR:

> But the question is, that I asked you, was what consideration was given to those people putting money into companies that your department said were offside and the real estate values were down? What protection were they to get from that investment? What was your consideration to them?

A My consideration was the overall public good which I thought benefited them as well.

THE INSPECTOR:

> I don't follow that. Perhaps you could explain to me how they're putting money into these companies did something for their good?

A They're putting their money into these companies did not necessarily, except for the interest rate that they were earning, was not necessarily, if you look down the road at eventually what happened, in their best interests. But, Mr. Code, this was the very — I guess the position that we were in in trying to judge what was going to be best in the longer term. And I have no explanation other than that.

THE INSPECTOR:

> And they would then be carrying out the government policy by putting money into something that could have been taken down?

A Yes, if you believed that, in fact, you had significant evidence to take them down.

THE INSPECTOR:

> Your department believed that, didn't they?

A Yes, they did.

Q MR. WITTMANN: Mrs. Osterman, put in another way, the policy that Mr. Saleh and Mr. Martin described, that is, workout, give them time, which you've indicated came from you, was developed with the knowledge that if your department auditors were correct, at least the new people coming — making investments in these companies could be harmed, individuals? That's your dilemma, isn't it?

A That's my dilemma, and certainly in the back of my mind I would have had some thoughts about what the future would bring had conditions stayed precisely the same. I think it's fair to say that I believed that the investors at the time would be greatly harmed, in fact the whole province would be, if we tried to publicly handle these two companies, which potentially was what would have happened had we got into the full-blown scenario of developing a plan for them, or sending in outside experts in the company to determine a number of matters. My view of the credit union system was so fragile that more publicity about financial institutions would have been incredibly negative, and indirectly impact these investors. [31115-7]

With respect to whether FIC and AIC were being given time to work out their problems while in breach of the *ICA*, Osterman testified as follows:

Q Well, was there any discussion about the idea that with the capital impairment or deficiency, the contract companies were in breach of the statute, violating the law?

A I don't know — it was a very gray area in terms of the discussions about what pertained in terms of the ongoing ability for the companies to operate, and because I felt that there had not been clarification of the company's position in terms of capital impairment, I did not pursue questions in that regard.

Q There was never any occasion to your memory, then, when a discussion occurred about giving the companies time in the context of, while, you are giving them time, they are in breach of the statute?

A No. I believe that that would be described by the regulator, if necessary. [31083-4]

Osterman testified that "it was my understanding that in terms of regulation, what was necessary would be done" [31478] and that "I left the decisions to the regulators with respect to what they must do to properly enforce the legislation". [31500] She testified that at no time did she conclude in her own mind that FIC and AIC were operating contrary to the law. [31493]

With respect to Saleh, she said as follows:

THE INSPECTOR:

I don't understand that. Sorry, you will have to go into that a little more. I mean, Mr. Saleh told you that as far as he is concerned they didn't meet the capital requirements.

A But it hadn't been totally clarified, and he did not say that the situation that they were in meant that in a statutory way that they had to have their licences cancelled. That was not communicated to me. I guess that is basically what I am saying.

THE INSPECTOR:

You had familiarity with the Act, but you relied on Mr. Saleh to tell you what the law was in relation to this and you are saying he just never said that they —

A That's right. [31211]

With respect to Martin, she testified as follows:

Q Now, I say again, I have to tell you in fairness that Mr. Martin has testified here that he was aware, in his judgment, that at least at some times these companies were not in compliance with the Act. Do you say that your Minister didn't tell you that or that he did tell you that? Your Deputy Minister, rather?

A He would have expressed to me the concern that that was a potential and that he would need an opinion on it. I believe there were several opinions sought about that — about various areas. The Transaction Number 1 being one of those areas.

Q Mrs. Osterman, my question to you is, do you say that the Deputy Minister told you that he was of the view that these companies were operating contrary to the Act or didn't he?

A He may have expressed it that way, otherwise he wouldn't have been looking for opinion to substantiate or not.

Q I don't know about the otherwise. I just want to know what you say. Did your Deputy Minister tell you of his view, which he says here on oath that he had, that the companies were, at least some of the time, operating contrary to the Act? Did he tell you that or not tell you that or you don't know if he told you that or something else?

A I am sure he would have expressed some — he would have raised the matter somehow. You are being — you are making an exact statement and saying did he tell you that or not.

Q Mrs. Osterman, I am not — I don't really care if he said it in those words or if he used semaphore or how he said it?

A Okay.

Q Did he let you know in writing, in talking through your executive assistant, by a memo, hand signals, innuendo, a wink, a nudge, I don't care how, that he was of the view that these companies at some of the time at least were operating contrary to the Act. Did your Deputy Minister do that?

A No. He would have used the term "may".

Q How do you know that, Mrs. Osterman?

A Because I recall that he was not — I did not believe him to communicate that he was firm in his judgment, therefore we needed opinions.

Q Now, are you saying to us that he did not do that or wouldn't have because you know his manner of speaking? I don't understand your answer.

A I am saying that he, in expression about an opinion, when giving an opinion, ordinarily he would say, they may be. And I am talking now — or I am speaking now about generally in his communication to me about areas that require an opinion, and I don't believe that he was wanting to express a legal opinion, so he would usually use may.

Q His testimony here, so you are aware, under oath was, I was aware; I was aware that the companies were in non-compliance with the Act. Now, did he say that to you?

A No. [31494-6]

I do not entirely accept this evidence. I find that Saleh and Martin told Osterman that according to the calculations of the Audit Section, which they accepted as accurate, FIC and AIC did not meet the requirements of the *ICA*. Given the position of the companies that they were not in breach of the *ICA*, it may be that Saleh and Martin were unable to say unequivocally that FIC and AIC were operating contrary to law in 1984, 1985 and the beginning of 1986. The evidence tends to show, however, that Osterman would not allow the necessary steps to be taken to confirm whether that was the case.

When Darwish tried to alert Osterman to what he believed was a very serious situation in 1984, she refused to read his memorandum and forced him out of CCA into early retirement. Having been told that in the opinion of the Audit Section, with which her Superintendent and Deputy Minister agreed, FIC and AIC did not satisfy the financial requirements of the *ICA*, and having been advised by her Superintendent that appraisals or the engagement of an independent consultant or both were necessary to confirm whether there was non-compliance, and if so to what extent, Osterman refused to do either and chose not to take any action at all. Indeed, she testified that she knew that the results of appraisals, if done, would not be favourable to the companies. The evidence tends to show that she knew the companies did not meet the requirements of the *ICA*. She took a conscious decision to simply wait and hope for an improvement in the economy, in accordance with her policy of attempting to preserve Alberta-based financial institutions, a consideration irrelevant to the purpose and objects of the *ICA*. In the meantime, she prepared no plan of action to deal with the companies.

The effective result of Osterman's conduct was that administration and enforcement of the *ICA* and regulation of FIC and AIC were suspended. This was in breach of her public duty to carry out the purpose and objects of the *ICA*.

This suspension was not made known to investors and the public. FIC and AIC continued to be licenced and were permitted by the regulators to state on their contract application forms that they were registered under the *ICA* and that the *ICA* required assets on deposit to equal 100% of certificate liabilities.

Osterman was prepared to allow the public to continue to invest in FIC and AIC when she had no idea whether the companies would be able to honour maturing obligations, because of what she perceived to be a greater public good. In the end, it was the investors who bore the risks of her decision and her policy and her hope that economic conditions would improve.

Osterman's conduct would best be considered in the context of negligence or misconduct in the carrying out of a public duty, matters which I am not empowered to consider. Pursuant to my mandate, I must consider whether her conduct amounts to fraud or dishonesty as those terms are defined in this Report. The law with respect to fraud and dishonesty is outlined in Appendix 1.

The evidence tends to show that Osterman's conduct was not fraudulent or dishonest for two reasons. First, the decision of the Privy Council in the case of *Yuen Kun Yeu et al.* v. *Attorney General of Hong Kong* referred to in Appendix 5 casts some doubt on whether the supervisory and licencing requirements of the *ICA* would amount to a representation to investors that FIC and AIC were in compliance with the *ICA*. Although I am of the view that the *Yuen Kun Yeu* case is distinguishable on its facts, and that the *ICA* is substantially different than the ordinance under consideration there, and is for the benefit of present and future investors, I cannot say with certainty that the law would recognize the continued licencing of FIC and AIC as a representation by those charged with administration of the *ICA* that the companies met the statutory requirements.

Second, the evidence tends to show that Osterman was preoccupied with the larger question of the status of the financial industry in Alberta and especially the credit unions, concerning the greater public good, to the exclusion of the particular statutory duties delegated to her under the *ICA* or delegated to others and effectively usurped by her. The evidence tends to show that Osterman failed to discharge her duty to administer and enforce the *ICA*. She refused to act on the specific recommendations coming up from her subordinates and insisted on treating FIC and AIC as part of the larger question. The evidence tends to show that such conduct was naive and misguided. My mandate is to report on evidence tending to show fraud or dishonesty. The evidence tends to show that Osterman's conduct in these circumstances does not fit within those terms because although she was neglectful, misguided or even reckless, her intentions were not in any way dishonest.

According to Ryan, new term certificates totalling $328,602,585.58 were purchased by investors after December 31, 1983 and remained outstanding as at June 30, 1987. Of the term certificates in existence as at December 31, 1983, $60,244,532.86 worth were rolled over during the period January 1, 1984 to June 30, 1987 and remained outstanding as at June 30, 1987. [Exhibit 636] Had the companies' licences been suspended or cancelled in 1984, not all of this money would have been invested and the loss to investors would not have been as great; just how much smaller I am unable to say.

(d) Task Forces and Priorities Committee

Hyndman referred to Government policy in 1984 and 1985 as follows:

> . . . the policy was to take whatever steps could be, to try to, firstly, hold or ensure that the confidence of business and consumers didn't drop too far, and also to suggest that there were some basic long-term strengths in the Alberta economy, and that everyone should be aware of that, and that we had a future. [33843]

He could neither confirm nor deny whether CCA had an internal policy to defer action on FIC and AIC for any reason. [33819]

I accept the evidence of Hyndman, McPherson and Osterman to the effect that both task forces and the Priorities Committee had little specific knowledge of the problems with FIC and AIC in 1984 and 1985. They would not become involved unless and until the Minister of CCA brought forward a recommendation and plan of action. That never happened.

(e) Alberta Treasury

The evidence shows that shortly after the transfer of administration, Alberta Treasury was in receipt of the interim and final 1985 annual examination reports on FIC and AIC, prepared by the Audit Section within CCA. Notwithstanding the results of these reports, the lengthy experience of the Audit Section in examining FIC and AIC and the concerns expressed by the British Columbia regulators, Johnston chose not to take any action on the basis thereof. Instead, the Loans and Guarantees section within Alberta Treasury commenced its own assessment of the companies. The evidence tends to show that it was not until late 1986, when Loans and Guarantees and the British Columbia regulators also began recommending the engagement of an independent consultant, that that was done.

In the meantime, investors continued to put money into the companies when Alberta Treasury had no idea whether they would be able to repay it. Johnston acknowledged that in his testimony, as follows:

> Q Well, again then during June '86, July, August, September and on and on it goes, and perhaps we are not disagreeing with one another but as this time is passing and people, to your knowledge, are putting their money in these companies, you didn't know whether they were ever going to get it back or not? You cared, I take it, whether they would get it back?
>
> A I cared and I hoped we would get the money back.
>
> Q You cared and you hoped?
>
> A But could not judge. [33257-8]

When asked whether he believed Alberta Treasury acted quickly enough after assuming jurisdiction over FIC and AIC, Johnston testified that the course of action adopted was appropriate to ensure that there was a solid basis for making a decision or recommendation to Cabinet, since there was a lot at stake. [33153-5] He was not prepared to make a recommendation on the basis of the examinations of CCA over the previous 13 years for at least two reasons: first, the economic situation in Alberta was different than it had been earlier, and that impacted on the quality of the assets; secondly, the emergence of the intercorporate transactions in 1985, 1986 and 1987 affected the quality of the assets and Treasury required more information about them. [33231-4]

Notwithstanding Johnston's evidence as to why Treasury did not take action in the summer of 1986, I have difficulty understanding this, given the findings of the Audit Section from its 1985 annual examinations and its knowledge from earlier examinations, and in light of the 1985 qualified audited financial statements received in May, 1986. It appears to me that there could be no valid dispute at that time as to whether FIC and AIC satisfied the financial requirements of the *ICA*.

In any event, I have difficulty understanding why the engagement of an independent consultant was delayed until the end of 1986, and by then I question whether it was necessary to engage a consultant at all, given the opinion of Loans and Guarantees in November of 1986 that FIC was effectively insolvent. Had Alberta Treasury acted sooner, it is likely that the losses to investors would have been less, although it is impossible to quantify the amount. The value of the real estate held by FIC and AIC may have been greater as well, resulting in a higher realization for investors. Johnston's evidence was that Treasury believed the market value of real estate declined dramatically in 1986 and 1987. [33388]

Notwithstanding these comments I find that the evidence does not tend to show the conduct of the Provincial Treasurer or officials within Alberta Treasury to be either fraudulent or dishonest.

3. Effect of the Administration of the Investment Contracts Act on the Sales Practices of FIC and AIC

The effect of the inability and unwillingness of the regulators to address the problems of FIC and AIC may be seen here as well.

I have already found that single pay certificates are not investment contracts as defined in the *ICA*. It follows that the regulators had no authority to approve the contract forms or materials used by FIC and AIC with respect to those certificates.

Notwithstanding this, the regulators approved contract forms and permitted the companies to state that they were registered under the *ICA* and that the *ICA* required assets on deposit equal to 100% of liabilities. The evidence tends to show that such wording was the single most effective sales tool used by salesmen to sell FIC and AIC certificates. The evidence tends to show that CCA allowed the companies to make these representations when it knew that FIC and AIC did not have such assets and no steps were being taken to enforce compliance with the *ICA*. The only action taken was a wording change suggested by the Superintendent in 1984 which did nothing to correct the misrepresentation. Alberta Treasury took no steps to have the wording changed upon its assumption of jurisdiction over FIC and AIC even though it knew or ought to have known that it was untrue, and the misrepresentations continued to be made until June 30, 1987.

The evidence also tends to show that CCA was aware of sales practices which it considered to be misleading, yet a proposed investigation in 1984 was called off at the direction of the Deputy Minister for fear of drawing attention to the companies and no action was taken to stop such practices.

The evidence also tends to show that CCA was aware that the Annual Reports, which had not been submitted to the Superintendent for approval, were or could be used as a sales tool. Alberta Treasury was of the view that the 1985 Annual Review was misleading and should have been aware that it could be used as a sales tool. No steps were taken by the regulators to require approval of such materials or prevent their use in promotion of FIC and AIC.

APPENDIX 1

FRAUD

1. INTRODUCTION

The law of fraud forms a part of the legal framework that guided my investigation because the mandate included investigating whether the business or affairs of FIC and AIC or any of their affiliates was carried on with intent to defraud any person, and whether persons concerned in the matter have acted fraudulently or dishonestly.

The law of fraud is categorized as follows. In civil law, fraudulent misrepresentation is the foundation for the tort of deceit. Where the intentional element is absent there may nevertheless be a civil remedy in cases involving a fiduciary duty; this is known as constructive fraud and was developed by the courts of equity. The authorities often refer to the foregoing civil law causes of action as actual fraud and constructive fraud, respectively.

In criminal law it is an offence to defraud the public or any person of any property, money or valuable security by deceit, falsehood or other fraudulent means. The offence is codified in s. 380(1) of the *Criminal Code*, R.S.C. 1985, c. C-46. Part X of the *Criminal Code* is headed Fraudulent Transactions Relating to Contracts and Trade, and under the subheading Fraud includes a series of offences in ss. 380-396 concerning such things as using mails to defraud (s. 381) and fraudulent sale of real property (s. 387). Of particular significance here, in addition to s. 380(1) are s. 380(2) which concerns fraudulently affecting a public market, and s. 382 concerning fraudulent manipulation of stock exchange transactions.

Sections 380(2) and 382 are considered in Appendix 5. Section 380(1) is considered below, immediately following upon consideration of civil fraud.

While there are no Canadian decisions which have judicially considered the words "defraud" and "fraudulent purpose" within the meaning of s. 223(2) of the *BCA* or s. 229(2) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, these same words as found in s. 275 of the U.K. *Companies Act, 1929*, (19 and 20 Geo. 5), c. 23 have been considered. In *In re Patrick and Lyon Ltd.*, [1933] Ch. 786 (Ch. D.) at 790 the court stated that those words:

> . . . connote actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame. . . .

In *In re William C. Leitch Brothers, Limited*, [1932] 2 Ch. 71 (Ch. D.), at 77 it was held:

> . . . [W]ith regard to the meaning of the phrase carrying on business "with intent to defraud creditors" that, if a company continues to carry on business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts, it is, in general, a proper inference that the company is carrying on business with intent to defraud . . . .

The House of Lords, in considering the word "defraud" in *Scott* v. *Metro Police Comm.*, [1974] 3 All E.R. 1032 stated at 1038:

> . . . If, as I think, and as the Criminal Law Revision Committee appears to have thought, "fraudulently" means "dishonestly" then to "defraud" ordinarily means in my opinion to deprive a person dishonestly of something which is his or of something to which he is or would or might but for the perpetration of the fraud, be entitled.

Scott was followed in the leading Canadian case of *Olan*, *infra*.

In *Independent Lumber Company* v. *Gardiner* (1910), 13 W.L.R. 548 (Sask. C.A.) at 551 the following appears:

> . . . What is actual fraud is difficult to define. Its forms are so many and so various that Courts have avoided hampering themselves with a specific definition of what shall constitute it, but have left themselves free to deal with it in whatever form it may present itself. It may, however, be said to mean "any dishonest dealing," and includes "all acts, omissions, and concealments which involve a breach of any legal or equitable duty, trust or confidence duly reposed, and which are injurious to another or by which an undue or unconscionable advantage is taken of another": Kerr on Fraud and Mistake, p. 1. Whether the acts or omissions relied upon amount to fraud, in the circumstances of each particular case, is a question of fact.

The Quebec Court of Sessions of the Peace in *R.* v. *Littler* (1972), 13 C.C.C. (2d) 530 at 550, varied on other grounds 27 C.C.C. (2d) 216 at 234 (Que. C.A.) distinguished "fraud" from "false pretenses" as follows:

> . . . However, fraud is much wider in scope. It includes all these calculated and wilful false statements, half-truths, omissions, even mere secrecy, all these direct or indirect lies and falsehoods, disloyal or fraudulent means deliberately used by its author to his benefit or the benefit of third parties, which may not be characterized fully as a false pretense, but which create a state of mind inducing a person to follow a course of action to its detriment and injury, causing the loss of any property or valuable security, a course of action which such person would not have followed, had the fraudulent and deceitful means taken been known.

2. CIVIL AND CRIMINAL FRAUD DISTINGUISHED

Private law remedies for fraudulent conduct include damages where the tort of deceit is made out and rescission of a contract entered into on the basis of a fraudulent misrepresentation. Criminal law sanctions for fraud include fines and imprisonment. Private, or civil cases are decided on the balance of probabilities. In criminal law cases the prosecution has the onus of establishing all of the requisite elements of an offence beyond a reasonable doubt.

Civil fraud and criminal fraud have some elements in common. An essential element of both is conduct which may objectively be characterized as dishonest. A second common element is the consequence of the dishonest conduct; in criminal law terms a deprivation, real or potential, must be shown; in civil law terms damage must be shown. Thirdly, a mental element is common to both civil and criminal fraud.

Bayda, C.J.S. emphasized the distinction between civil and criminal fraud in *R.* v. *Sebe*, *infra*, as follows at 102:

> One must always be careful with the notions of "deceit" and "fraud" when used in relation to the means of committing a defrauding under s. 338 [now s. 380] of the *Criminal Code*. The notions appear to have been imported into the criminal law from the civil law of torts and the law of contracts, where intent does not always have the same important role. Negligence and carelessness often serve as substitutes for intent. Whatever may be their meanings in the civil law, the notions of deceit, falsehood and fraud, when used in a criminal law context, connote an element of subjective or deliberate dishonesty. . . .

In *R.* v. *Humes* (1978), 38 C.C.C. (2d) 241 (Ont. C.A.) the accused was charged with defrauding his employer of money. Money was repaid by the accused to his employer who in consideration released the accused from any civil claim "and for the accountability of various funds". Considering the release the trial judge reasoned that a criminal conviction would be an abuse of process. On appeal that reasoning was ruled to be erroneous. Martin, J.A. for the court held at 244 that, "The release of the respondent by the complainant from civil liability, did not debar the conviction of the respondent for fraud if the offence was established".

3. CIVIL FRAUD DELINEATED

Civil actions brought by plaintiffs founded on the tort of deceit nowadays have largely been displaced by actions founded on the tort of negligent misstatement or misrepresentation. Generally speaking all the plaintiff need show is that the defendant owed the duty of care required to establish liability for a false statement honestly but negligently made pursuant to the authority of *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.*, [1964] A.C. 465. To a plaintiff who can establish liability in negligence the requirements to prove deceit may be of only academic interest, because tort liability is made out and the same damages would flow, subject to the possibility that exemplary damages may be awarded in cases of deceit. Pursuant to *Rookes* v. *Barnard*, [1964] A.C. 1129 such damages may be awarded where the defendant has acted tortiously with a view to profit. Whether deceit is within the category is unclear; the cases and arguments are considered in *McGregor On Damages* (1988, 15th ed.) at 421-423 and 1738.

The absence of a fraudulent intent is fatal to a claim founded on the tort of deceit. Mere negligence is a less onerous test.

> Since the famous case of *Pasley* v. *Freeman* (1789), 3 T.R. 51 . . . it has been the rule that A is liable in tort to B if he knowingly or recklessly (i.e., not caring whether it is true or false) makes a false statement to B with intent that it shall be acted upon by B, who does act upon it and thereby suffers damage. This is the tort of deceit, and [under the authority of *Derry* v. *Peek* (1889), 14 App. Cas. 337] for liability in deceit the defendant must make the statement with knowledge of its falsity or at least reckless whether it is true or false. Rogers, *Winfield and Jolowicz on Tort* (1975, 10th ed.) at 212.

(a) *The Law of Deceit*

A leading statement in modern law laying out the essentials of deceit is the judgment of Viscount Maugham in *Bradford Third Equitable Benefit Building Society* v. *Borders*, [1941] 2 All E.R. 205 (H.L.), and in particular the following passage at 211:

> My Lords, we are dealing here with a common law action of deceit, which requires four things to be established. First, there must be a representation of fact made by words, or, it may be, by conduct. The phrase will include a case where the defendant has manifestly approved and adopted a representation made by some third person. On the other hand, mere silence, however morally wrong, will not support an action of deceit: *Peek* v. *Gurney* [(1873), L.R. 6 H.L. 377; affg. (1871) L.R. 13 Eq. 79] at p. 390 *per* LORD CHELMSFORD, and at p. 403, *per* LORD CAIRNS, and *Arkwright* v. *Newbold* [(1881), 17 Ch. D. 301], at p. 318. Secondly, the representation must be made with a knowledge that it is false. It must be wilfully false, or at least made in the absence of any genuine belief that it is true: *Derry* v. *Peek* [(1889), 14 App. Cas. 337; revsg. (1887) 37 Ch. D. 541] and *Nocton* v. *Ashburton (Lord)* [[1914] A.C. 932.] Thirdly, it must be made with the intention that it should be acted upon by the plaintiff, or by a class of persons which will include the plaintiff in the manner which resulted in damage to him: *Peek* v. *Gurney* [*supra*] and *Smith* v. *Chadwick* [(1884), 9 App. Cas. 187], at p. 201. If, however, fraud be established, it is immaterial that there was no intention to cheat or injure the person to whom the false statement was made: *Derry* v. *Peek* [*supra*] at p. 374, and *Peek* v. *Gurney* [*supra*] at p. 409. Fourthly, it must be proved that the plaintiff has acted upon the false statement and has sustained damage by so doing: *Clarke* v. *Dickson* [(1859), 6 C.B.N.S. 453]. I am not of course, attempting to make a complete statement of the law of deceit, but only to state the main facts which a plaintiff must establish.

(i) *Representation of Fact*

Spencer Bower and Turner in *The Law of Actionable Misrepresentation*, (1974, 3rd ed.) at 3, define "representation" as follows:

> . . . [a] statement made by, or on behalf of, one person (. . . "the representor") to, or with the intention that it shall come to the notice of, another person (. . . "the representee"), which relates, by way of affirmation, denial, description, or otherwise, to a matter of fact. A "matter of fact" means either an existing fact or thing, or a past event.

A "representee" is defined by Spencer Bower and Turner, [*supra*], at 185 as including:

> . . . [A]ny person either to whom the representation is directly and immediately made, or to whose notice, though not so made to him, it is intended to come, and does come. . . .

Spencer Bower and Turner, *supra*, citing *Swift* v. *Winterbotham* (1873), L.R. 8 Q.B. 244 at 253, set out at 185-186 the three classes of persons to whom a representation may be deemed to have been made. These classes are identified as follows:

> a) The person to whom it was physically and directly made, or his principal, or partner;
>
> b) A specific person, not being the person to whom the representation was immediately made, nor his principal or partner, but whom the representor, either expressly or presumptively, intended it to reach and affect; and
>
> c) Any member of the public, or a section or class of the community, who acts upon any representation addressed in the first instance not to any specific individual, but to such public, section or class, and who accordingly thereupon becomes a representee.

In *Latus* v. *Beardsley* (1909), 10 W.L.R. 653 (Alta. S.C.), Stuart, J. stated at 653-654 with respect to a claim that the defendant had knowingly made false and fraudulent misrepresentations:

> . . . It is quite clear that such misrepresentations must be either of a past event or an existing fact, and not of something that would happen or would be done in the future. . . .

Generally speaking, a statement of opinion is not regarded as a statement of fact. It is possible, however, that a representation of fact may be inherent within a statement of opinion. A statement of opinion by a party with superior knowledge of the facts may imply that the representor has specific knowledge of facts which would justify the representor's opinion. As such, the statement of opinion may contain a representation of fact. In *Smith* v. *Land and House Property Corporation* (1884), 28 Ch. D. 7 (C.A.), Bowen, L.J. stated at 15:

> . . . It is material to observe that it is often fallaciously assumed that a statement of opinion cannot involve the statement of a fact. In a case where the facts are equally well known to both parties, what one of them says to the other is frequently nothing but an expression of opinion. The statement of such opinion is in a sense a statement of a fact, about the condition of the man's own mind, but only of an irrelevant fact, for it is of no consequence what the opinion is. But if the facts are not equally known to both sides, then a statement of opinion by the one who knows the facts best involves very often a statement of a material fact, for he impliedly states that he knows facts which justify his opinion. . , .

And in *Bisset* v. *Wilkinson and Another*, [1927] A.C. 177 (P.C.), Merrivale, L.J. stated at 182:

> . . . A representation of fact may be inherent in a statement of opinion and, at any rate, the existence of the opinion in the person stating it is a question of fact. . . .

Generally speaking silence will not be construed as a representation of fact. However, there are instances where silence may amount to a representation. Spencer Bower and Turner, *supra*, state at 6:

> Where a representation, by reason of the omission therefrom of all reference to qualifying conditions, subject to which alone it would be true, or by reason of the representor's suppression of facts which in the circumstances of the individual case it was his duty to disclose, is rendered a partial, fragmentary, incomplete, or misleading representation of the

> entirety of the facts to which it relates, it is deemed false, notwithstanding that the statement, or each of the statements, if more than one, made by the representor may be, when taken by itself, literally accurate. Except as aforesaid, silence or reticence is not a misrepresentation.

There are a number of examples among the cases of silence amounting to misrepresentation. *Abel* v. *McDonald*, [1964] 2 O.R. 256 (C.A.) at 259 held that non-disclosure on the part of the defendants by actively preventing the facts from being disclosed to the appellant amounted to a fraud.

In *Canadian Farm Implement Company Limited* v. *Alberta Foundry & Machine Company Limited*, [1927] 1 W.W.R. 1025 (Alta. S.C. T.D.) at 1027 the court held that fraud had occurred in circumstances where the statement made was true, but where the qualifications which would have rendered it accurate were intentionally withheld.

In *Sevidal* v. *Chopra* (1987), 64 O.R. (2d) 169 (H.C.) at 187-189, the court held that the vendors were liable in deceit where they had failed to disclose a dangerous latent defect in the land being sold prior to the signing of the purchase and sale agreement. It was held that the failure to disclose changes in the facts between the time of the agreement and the closing of the sale also amounted to fraud.

Cases where silence amounts to misrepresentation are the exception. In *Sorensen and Sorensen* v. *Kaye Holdings Ltd. et al.*, [1979] 6 W.W.R. 193 (B.C.C.A.), leave to appeal to S.C.C. refused 31 N.R. 445n, the court states at 225 as follows:

> The first question is whether silence constituted a misrepresentation. This is not a contract of utmost good faith, nor was there a fiduciary relationship between the parties. In the absence of such a special contract or relationship, it is not deceit for a vendor to fail to decry his own wares unless he makes some positive assertion that becomes distorted by the failure.

The cases where silence is misrepresentation include intentional suppression of the facts and active concealment of the facts. For example, in *Leeson* v. *Darlow*, [1926] 4 D.L.R. 415 (Ont. C.A.) Masten, J.A. stated at 432:

> . . . Active concealment of a fact is equivalent to a positive statement that the fact does not exist. By active concealment is meant any act done with intent to prevent a fact from being discovered; for example, to cover over the defects of an article sold with intent that they shall not be discovered by the buyer has the same effect in law as the statement in words that those defects do not exist. (*Horsfall* v. *Thomas* (1862), 1 H. & C. 90, 158 E.R. 813; *Schnieder* v. *Heath* (1813), 3 Camp. 506)

In *Oakes* v. *Turquand and Harding*; *Peek* v. *The Same* (1867), L.R. 2 H.L. 325 (H.L.) Lord Chelmsford, L.C. stated at 342-343:

> It is said that everything which is stated in the prospectus is literally true, and so it is. But the objection to it is, not that it does not state the truth as far as it goes, but that it conceals most material facts with which the public ought to have been made acquainted, the very concealment of which gives to the truth which is told the character of falsehood. . . .

The false representation may be conveyed by words or conduct. In *NIR Oil Ltd. and Cohen* v. *Bodrug* (1983), 47 A.R. 127 (Q.B.), affirmed on other grounds 38 Alta. L.R. (2d) 321 (C.A.), leave to appeal to S.C.C. refused 39 Alta. L.R. (2d) xlvi, McDonald, J. set out the type of conduct required for an action in deceit, at 137:

> . . . What the common law contemplates as a misrepresentation of fact, or an active concealment of a material fact, is some kind of conduct which prevents the other party from discovering the true state of affairs or discourages the other party from making an effort to ascertain what the true state of affairs is. . . .

(ii) *Knowledge*

Viscount Maugham's second requirement for deceit is that "the representation must be made with a knowledge that it is false." A *bona fide* belief in the truth of the statement, even without reasonable grounds, will be a complete answer.

In *Derry* v. *Peek*, *supra*, a tramway company was incorporated by a special act which provided that the tramway's carriages could be moved by animal power and, with the consent of the Board of Trade, by steam power. The directors of the company issued a prospectus containing a statement that the company had the right to use steam power instead of horses. The directors honestly believed that the consent of the Board of Trade in that respect would be forthcoming; however, the Board of Trade refused its consent. The House of Lords held that the directors' carelessness and lack of reasonable grounds for their belief did not amount to deceit. Lord Herschell, in an oft quoted passage, stated at 374-376:

> . . . First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made. . . .
>
> In my opinion making a false statement through want of care falls far short of, and is a very different thing from, fraud, and the same may be said of a false representation honestly believed though on insufficient grounds. . . .
>
> At the same time I desire to say distinctly that when a false statement has been made the questions whether there were reasonable grounds for believing it, and what were the means of knowledge in the possession of the person making it, are most weighty matters for consideration. The ground upon which an alleged belief was founded is a most important test of its reality. I can conceive many cases where the fact that an alleged belief was destitute of all reasonable foundation would suffice of itself to convince the Court that it was not really entertained, and that the representation was a fraudulent one. So, too, although means of knowledge are, . . . a very different thing from knowledge, if I thought that a person making a false statement had shut his eyes to the facts, or purposely abstained from inquiring into them, I should hold that honest belief was absent, and that he was just as fraudulent as if he had knowingly stated that which was false.

In his reasons for judgment Lord FitzGerald stated at 358 that he preferred to follow the opinion of Lord Cramworth in *Western Bank of Scotland* v. *Addie*, Law Rep. 1 H.L., Sc. 145, 168, in which he said:

> . . . If persons in the situation of directors of a bank make statements as to the condition of its affairs, which they *bona fide* believe to be true, I cannot think they can be guilty of fraud, because other persons think, or the Court thinks, or your Lordships think, that there was no sufficient ground to warrant the opinion which they had formed. If a little more care and caution must have led the directors to a conclusion different from that which they put forth, this may afford strong evidence to shew that they did not really believe in the truth of what they stated, and so that they were guilty of fraud. But this would be the consequence, not of their having stated as true what they had not reasonable grounds to believe to be true, but of their having stated as true what they did not believe to be true.

In *Parker* v. *McQuesten* (1872), 32 U.C.Q.B. 273 (C.A.) the plaintiff brought an action against the directors of a bank alleging that they had fraudulently misrepresented the condition of the bank in their report to the shareholders and the statement accompanying it by over-estimating its assets and under-estimating its liabilities, thereby inducing the defendant to purchase stock in the bank. The credit of the bank became impaired due to the failure of other banks. The statements showed certain debentures as assets at their par value, although they were worth much less at market value. The cashier who prepared the report and statement stated that he regarded these debentures as capital invested at a low rate of interest. With respect to many of the assets that were alleged to be over-valued, the cashier stated that he believed that the sum reserved to meet losses was fairly sufficient and that the forced sale of bank properties involved great sacrifices in their value. The court held that there was no evidence of fraud sufficient to maintain an action. Richards, C.J. stated at 292-293:

> No doubt, if a strict and exact statement was required to be made of any asset in its value, and the price it would realize if thrown into the market and a sale forced, these debentures, and probably many of the properties of the bank, as well as debts, were estimated too high. But considering the Rest, the sums put to credit of profit and loss, which the cashier said were for the purpose of covering any of these losses or under-estimates, is there evidence to go to the jury of false statements knowingly made with a fraudulent intent by this defendant? Is there evidence to go to the jury that the cashier and the directors of the bank made up this statement and published it to the world with the intention to cheat and defraud parties who might feel inclined to buy bank stock, — in fact, to induce parties to pay a high price for shares in this bank, when they knew and believed at the time it was not only not in a position to pay the dividend they were declaring, but that the capital of the bank itself had been considerably impaired?
>
> It can hardly be supposed that anyone who read the statement and report would be of opinion that all the assets of the bank could or would be realized at the value put down, . . . I should suppose that every one would consider that all the assets would not be realized at the estimated value. . . .
>
> The fact that the bank suffered largely by the failures of the Bank of Upper Canada, McIntyre & Co., Buchanan & Co., and by the apparently forced sale of some of their assets, cannot now fairly be pressed against this defendant, that he was acting fraudulently in 1866 in joining in the report.

In *Petrie* v. *The Guelph Lumber Company* (1886), 11 S.C.R. 450 the plaintiffs alleged that they had been induced to invest in a company by false representations in a prospectus. The court held that the evidence failed to establish fraud. Gwynne, J. stated at 463-464:

> . . . If the directors *bona fide* believe the representation to be true, the action will not lie, but then the *bona fides* of the belief is a fact which is to be tested and determined upon a consideration of the grounds of belief; but before we can arrive at the conclusion that the representations were made fraudulently and not under the influence of a *bona fide* belief in their truth, the insufficiency of the grounds to warrant such belief should be apparent beyond all controversy, for some persons may entertain a *bona fide* belief in the existence of a fact upon the grounds which, in other minds, might not give birth to the same belief, and the question is not whether, in the opinion of the persons testing the *bona fides* of the belief of another in the existence of the fact, there were sufficient grounds to warrant the belief, but whether in point of fact the belief was *bona fide* entertained by the persons who assert that they entertained it. . . .

Gwynne, J. went on to state at 481 that ". . . bad management and fraud are matters very different in their nature . . .".

In *McLaughlin* v. *Colvin*, [1941] 4 D.L.R. 568 (Ont. C.A.) the court held that a statement that the purchase price for shares had been raised, which was in fact a false representation, was not fraudulent. Masten, J.A. stated at 583:

> . . . It may be that he was negligent in not making sure and it may be that carelessness and wishful thinking combined to induce the representation which appellant made, but that is not enough to establish fraud in the absence of moral recklessness and a callous disregard as to whether the statement is false or true. I cannot formulate the principle more succinctly or in better terms than as it appears in 23 Hals. (2nd ed.), pp. 45-46, para. 63: "It is well established that a misrepresentation which was founded on a belief in its truth, if that belief really existed, and was genuinely and honestly entertained, is not deprived of its character of innocence by reason of the mere fact that the belief resulted from want of care, skill, or competence, or lapse of memory, though such conduct, in other aspects, may have been of a most culpable character. Negligence is not dishonesty; . . . Carelessness or stupidity in arriving at a genuine conviction ought not to be, though it frequently has been, confounded with that moral recklessness or callousness, already referred to, which prompts the putting forward of a misrepresentation as to which the representor has no belief at all."

In *Bradford Third Equitable Benefit Building Society* v. *Borders*, *supra*, Wright, L.J. stated at 220:

> . . . Fraud involves deliberate intent, which is called *mens rea*. Nothing short of the wicked or guilty mind will serve, as this House held in most striking circumstances in *Derry* v. *Peek* (1889), 14 App. Cas. 337, where the statement complained of was, to the knowledge of the directors, not true in fact, but they mistakenly thought it was as good as true, whereas events completely falsified their expectation, to the damage of the plaintiffs. However, the directors were held not to be liable, because they were innocent of any intention to deceive. . . .

Finally on the matter of knowledge, in *Kober* v. *McArthur* (1984), 36 Alta. L.R. (2d) 152 (Q.B.) the plaintiff complained that he had been induced to purchase shares in a company operated and controlled by the defendant on the basis of the defendant's representations that the shares were a good investment and that they would be traded publicly in the near future. The company was subsequently struck from the register and the shares were never traded publicly and eventually became worthless. The court held that the defendant's statements were not fraudulent because the defendant honestly believed them to be true. Medhurst, J. stated at 158:

> . . . A fraudulent misrepresentation is a representation of fact made without any belief in its truth with intent that the person to whom it is made shall act upon it and actually causing that person to act upon it. The one point that is of concern is whether or not the defendant made the misstatement to the plaintiff dishonestly or recklessly so as to be deceitful. As I have said, I have no doubt at this stage of the proceedings that at the time the defendant may have actually thought the affairs of the business were so good that it would soon become public. This is not fraud in the true sense of the word, but it is negligence in making a misstatement of fact. . . .

(iii) *Reliance*

Thirdly, according to Viscount Maugham, to show deceit the representation must be made "with the intention that it should be acted upon by the plaintiff". The two factors of intent and reliance are often combined into one issue, namely, whether the false representation was a "material inducement" to the representee.

Inducement may be analyzed in two stages: the first stage requires that it be shown that the representor made the representation *intending* to induce the representee to alter his position; the second stage requires that the representee establish that the representation had the *effect* of inducing him to alter his position. *See*: *Hinchey* v. *Gonda*, [1955] O.W.N. 125 (H.C.) at 127; Spencer Bower and Turner, *supra*, at 132; and *Sedgemore* v. *Block Bros. Realty Ltd.* (1985), 39 R.P.R. 38 (B.C.S.C.) at 48.

To establish inducement, it is not necessary to show that the false representation was the *sole* cause of the representee's action; it is sufficient if the representee can establish that his conduct might have been different had he known the truth. In *Smith* v. *Chadwick* (1884), 9 A.C. 187 (H.L.) the court held that where the representation is ambiguous, the representee must also prove that he interpreted it in a sense which was false and relied upon such an interpretation.

When more than one meaning can be attributed to a particular statement, the representee must prove that he understood the statement in a particular sense and that he acted upon it in that sense, and that he was reasonable in doing both. *See*: *Schroeder et al.* v. *Mendl et al.* (1877), 37 L.T. 452 (C.A.); and Spencer Bower and Turner, *supra*, at 88.

In *Chapman* v. *Warren*, [1936] 2 D.L.R. 157 (Ont. S.C.) the plaintiff brought an action for deceit against directors of certain companies in which he had been induced to invest on the basis of alleged false statements contained in their prospectus. The court dismissed the plaintiff's action as the plaintiff failed to show that there were any false statements contained in the prospectus and further that the plaintiff had relied on any such statements. Kingstone, J. stated at 162:

> On her own admission the prospectus made little, if any, impression on her and the statements made by the agent who induced her to take these bonds were not such as to exceed, if at all, the customary puffing used and rosy coloured pictures drawn by agents employed in the business of selling bonds and stocks. The natural conclusion is that what the plaintiff chiefly relied on, and induced her to enter into this transaction, was the advice of her father.

In *Daeyoo Enterprise Co.* v. *Long* (1986), 75 A.R. 47 (Q.B.) the purchasers of a business defaulted on payment of a promissory note in favour of the vendor. The vendor sued on the note. The purchaser claimed that the vendor had fraudulently or negligently misrepresented the financial information that the purchasers had relied upon in making the purchase. The purchasers had been given an interim financial statement in which the 1982 income was stated to be approximately $80,000. A pro forma was prepared based on that statement. The vendor gave the purchasers the name and telephone number of the accountant should they need any further information.

Three days before the sale closed, the purchasers were given the 1982 financial statement, which showed that the income was $56,000 and not $88,000. The court held that as no vital financial information was deliberately or negligently withheld, no fraudulent misrepresentation had been made. The purchasers had all of the financial information made available to them and had they examined it diligently, they would have been in a position to rescind the contract. Chrumka, J. stated at 55- 56:

> . . . [The purchasers] were at liberty to make their own calculations. There was nothing in those documents which misrepresented the income nor were there any oral misrepresentations made with respect to the 1983 income. [The purchaser] was also advised by [the vendor] to speak with the company accountant and he was not only given the name, but also the telephone number of the accountant.
>
> • • • • •
>
> It is also significant that in November, 1983, when [the purchaser] examined the financial statement of May 31, 1983, and became aware that the actual income for 1982 was much less than shown in the Proforma, neither [of the purchasers] contacted [the vendor] and suggested fraud or misrepresentation of any kind at that time. Fraudulent misrepresentation is raised only when they cannot meet their obligations under the promissory note and they are sued. . . .

Not only must the representation have induced the conduct of the representee, it must be materially capable of it in the sense that its natural and probable result would be to induce a representee to act on it: *Credit Bureau of Regina Ltd.* v. *Adpat Holdings Ltd.* (1984), 33 Sask. R. 115 (Q.B.) at 126.

The misrepresentation must be a material factor in the inducement and not merely an incidental factor. A representation is considered to be material when its natural and probable result is to induce the representee to enter into the contract in which he entered or altered his position in the manner in which he did: Spencer Bower and Turner, *supra*, at 144; *Hinchey* v. *Gonda*, *supra* at 127; *CRF*

Holdings Ltd. et al. v. *Fundy Chemical International Limited and Smerchanski*, [1982] 2 W.W.R. 385 (B.C.C.A.) at 391 and *Sedgemore* v. *Block Bros. Realty Ltd.*, *supra* at 48.

In determining whether the representation was of a nature to induce or did actually induce the representee to alter his position, the court will look to what the entire effect must have been on the representee's mind of all of the information given, and not just to the effect of any particular passage, statement, or document: *Derry* v. *Peek*, *supra*; *Gross* v. *Louis Hillman Ltd.*, [1969] 3 All E.R. 1476 (C.A.) at 1480; and *Bloomenthal* v. *Ford*, [1897] A.C. 156 (H.L.) at 163. The court must consider the way in which the representation is alleged to have been made, the nature of the transaction, the business experience of the representor and representee, the context in which the statement was made, and the present and past relations of the parties to one another: *Bloomenthal* v. *Ford*, *supra* at 169; Spencer Bower & Turner, *supra* at 157; *Morin Technical Services (1978) Ltd.* v. *Morin* (1982), 40 A.R. 15 (Q.B.); and *Loewen* v. *Hanford Homes Ltd.* (1983), Man. R. (2d) 131 (Q.B.).

(iv) *Damage*

"Fourthly", according to Viscount Maugham, "it must be proved that the plaintiff has acted upon the false statement and has sustained damage by so doing." In addition to proving that the representor made a false representation of fact, with knowledge of its falsity, and with the intention that the representee rely upon it, the representee must establish that he did in fact rely upon it and that he suffered damage as a result of the fraudulent misrepresentation.

In *Sorensen* v. *Kaye Holdings*, *supra*, the court dismissed the plaintiff's action for fraudulent misrepresentation on the basis that the plaintiffs had failed to adduce evidence that the price they paid for certain property was more than its actual value.

In *Burns* v. *Kelly Peters & Associates Ltd.*, [1987] 6 W.W.R. 1 (B.C.C.A.) KPA Financial Consulting Business encouraged its clients to purchase life insurance policies from Monarch. KPA did not inform its clients that it exclusively sold Monarch's insurance policies. The plaintiffs brought an action in deceit on the basis of the advice they were given by KPA respecting a purchase of Monarch insurance policies. The court held that the non-disclosure by KPA that it sold exclusively Monarch insurance policies did not amount to fraud because the plaintiffs had failed to adduce any evidence that the insurance policies were not in fact suitable for the plaintiffs' needs. MacFarlane, J.A. stated at 36:

> The fact that the life insurance was purchased from Monarch would only have been material had the insurance coverage provided by Monarch been less suitable for the needs of any client or more expensive than the insurance which could have been obtained from another company. There is no evidence that that was the case. There was no need for detached advice with respect to the selection of an insurer because the selection of Monarch as an insurer was not material in the circumstances.
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> There was evidence that the failure of a life insurance agent to disclose that he is the agent of a particular company is considered by the insurance industry to be unethical. But in my opinion non-disclosure by the defendants that they were agents of Monarch for the purpose of the sale of life insurance, in the circumstances of this case, falls far short of establishing the tort of deceit.

(b) *Constructive or Equitable Fraud*

The courts of equity and courts of common law were once separate but are not anymore. The merged courts are empowered to grant common law remedies, such as damages, as well as equitable remedies, such as specific performance and injunctions. Maudsley and Martin, *Hanbury and Maudsley Modern Equity*, (1981, 11th ed.) explain at 3:

> . . . that, until the *Judicature Act* of 1873, the Court of Chancery had almost exclusive equity jurisdiction; rules of equity were not enforced in the common law courts. If a defendant to a common law action had an equitable defence to it, he had to go to Chancery to obtain an injunction to stay the proceedings in the common law court and then start a new action in Chancery to establish his equitable rights.

The historical events that lead to and explain the complex history of the law of equity are of no present concern. The matter is mentioned only to point out the source of and some general background to the law of equitable fraud, sometimes termed constructive fraud. It imposes a more onerous standard than does the common law of actual fraud, embodied in the tort of deceit. But equitable fraud has a much more narrow scope of application, and fewer available remedies.

Concerning sanctions *Hanbury and Maudsley Modern Equity* explains at 699 that:

> Equity has always used "fraud" to embrace a much wider variety of activities of which it disapproved, but to such situations its own remedies alone are applicable. Thus, while Equity's remedies are always available to supplement the common law in cases in which the common law definition of fraud is satisfied, only Equity's remedies (and not common law damages) are available to remedy the wider varieties of fraud recognized by Equity alone.

The same authority states that "Fraud in equity cannot be defined." *Ibid*. And it continues at 700:

> Under the head of constructive fraud, Equity recognizes a wide variety of situations in which intervention is justified by reason of a defendant's influence or dominance over a plaintiff in procuring his execution of a document (such as a settlement) or his entering into an obligation; Equity's intervention here is independent of any question of the accuracy of information supplied to the plaintiff. Equity intervenes in such cases, not because, as is the case with misrepresentations, the defendant has positively (albeit innocently) mislead the plaintiff on a particular and relevant point of fact, but because the defendant has caused the plaintiff's judgment to be clouded, with the result that the plaintiff has failed to consider the matter as he ought.

The leading case on constructive fraud is *Nocton* v. *Lord Ashburton*, [1914] A.C. 932 (H.L.) where Lord Haldane stated at 953-954:

> . . . It must now be taken to be settled that nothing short of proof of a fraudulent intention in the strict sense will suffice for an action of deceit. This is so whether a Court of Law or a Court of Equity, in the exercise of concurrent jurisdiction, is dealing with the claim, and in this strict sense it was quite natural that Lord Bramwell and Lord Herschell should say that there was no such thing as legal as distinguished from moral fraud. But when fraud is referred to in the wider sense in which the books are full of the expression, used in Chancery in describing cases which were within its exclusive jurisdiction, it is a mistake to suppose that an actual intention to cheat must always be proved. A man may misconceive the extent of the obligation which a Court of Equity imposes on him. His fault is that he has violated, however innocently because of his ignorance, an obligation which he must be taken by the Court to have known, and his conduct has in that sense always been called fraudulent, even in such a case as a technical fraud on a power. It was thus that the expression "constructive fraud" came into existence. The trustee who purchases the trust estate, the solicitor who makes a bargain with his client that cannot stand, have all for several centuries run the risk of the word fraudulent being applied to them. What it really means in this connection is, not moral fraud in the ordinary sense, but breach of the sort of obligation which is enforced by a Court that from the beginning regarded itself as a Court of conscience.

In *Canson Enterprises Ltd. and Fealty Enterprises Ltd.* v. *Boughton & Company et al.* (1988), 31 B.C.L.R. (2d) 46 (S.C.) MacDonell, J. stated at 55:

> Equitable fraud is the foundation underlying the concept of fiduciary duty; where a fiduciary obligation exists, an individual may be liable for conduct falling short of actual dishonesty

and may in fact have acted innocently. It is important at the outset to make this distinction between the type of intention required to prove these two classes of fraud.

The requisite special relationship importing the fiduciary duty and enabling the finding of constructive fraud has been found to exist for example between: a lawyer and client in *Canson Enterprises*, *ibid*; a principal and agent in *A.H.C.* v. *Achtem*, [1982] 2 W.W.R. 219 (Alta. Q.B.); a financial consultant and client in *Culling* v. *Sansai Securities*, [1974] 3 W.W.R. 686 (B.C.S.C.) and *Burns* v. *Kelly Peters and Assoc. Ltd.*, *supra*.

As is the case in an action at common law in deceit, the plaintiff must prove damage. The mere fact that a transaction results in a loss does not in and of itself justify a finding of fraud where there has been proper disclosure respecting the transaction.

4. CRIMINAL FRAUD DELINEATED

Section 380(1) of the *Criminal Code* provides as follows:

> 380(1) Everyone who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretense within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security,
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> (a) is guilty of an indictable offence and liable to imprisonment for a term not exceeding ten years, where the subject-matter of the fraud is a testamentary instrument or where the value thereof exceeds two hundred dollars; or
>
> (b) is guilty
>
> (i) of an indictable offence and is liable to imprisonment for a term not exceeding two years, or
>
> (ii) of an offence punishable on summary conviction,
>
> where the value of the property of which the public or any person is defrauded does not exceed two hundred dollars.

There is no definition of fraud in the *Criminal Code*, and thus the definition must be found in precedent. The classic definition is in the judgment of Buckley, J. in *Re London and Globe Finance Corp. Ltd.*, [1903] 1 Ch. 728 (Ch.) at 732-733:

> . . . To deceive is . . . to induce a man to believe that a thing is true which is false, and which the person practicing the deceit knows or believes to be false. To defraud is to deprive by deceit: it is by deceit to induce a man to act to his injury. More tersely it may be put, that to deceive is by falsehood to induce a state of mind; to defraud is by deceit to induce a course of action. . . .

It was held in *Scott* v. *Metropolitan Police Commissioner*, [1974] 3 All E.R. 1032 (H.L.) at 1035 and 1038, that the foregoing definition is not "exhaustive" and that "to defraud" ordinarily means ". . . to deprive a person dishonestly of something which is his or of something to which he is or would or might but for the perpetration of the fraud, be entitled."

The leading Canadian case on criminal fraud is *R.* v. *Olan, Hudson and Hartnett*, [1978] 2 S.C.R. 1175 (hereafter referred to as "*Olan*"). There Dickson, J., as he then was, stated on behalf of the court at 1182:

> Courts, for good reason, have been loath to attempt anything in the nature of an exhaustive definition of "defraud" but one may safely say, upon the authorities, that two elements are essential, "dishonesty" and "deprivation". To succeed, the Crown must establish dishonest deprivation.

While the scope of "other fraudulent means" has been the subject of divergent judicial interpretation and has not been exhaustively defined, the Supreme Court of Canada in *Olan*, *supra*, held at 1180 that "The words 'other fraudulent means' in s. 338(1) [now 380(1)] include means which are not in the nature of a falsehood or a deceit; they encompass all other means which can properly be stigmatized as dishonest".

Similarly, in *R.* v. *Renard* (1974), 17 C.C.C. (2d) 355 (Ont. C.A.) at 358, cited and approved in *Olan*, the court held that ". . . the words 'other fraudulent means' . . . are not restricted to means which are in a nature of falsehood or deceit". Martin, J.A., for the court, stated *ibid* that "A person may be defrauded by being deprived of something and he may be deprived of something either by being fraudulently induced to part with it or by having that to which he is entitled fraudulently diverted or withheld from him."

(a) *Dishonesty*

In *Lynch & Co.* v. *United States Fidelity & Guaranty Co.*, [1971] 1 O.R. 28 (H.C.) the court, after reviewing American authorities concerning the use of the term "dishonesty" in the context of fidelity bonds, stated at 37-38:

> From a review of the cases . . . the weight of authority seems to be that there must be something of the nature of intentional deception or concealment. The Shorter Oxford Dictionary, 3rd ed., in addition to certain obsolete meanings, gives "dishonest"the following meanings:
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> 4. of actions etc. not straightforward or honourable; underhand; now, fraudulent, knavish.
> 5. of persons, wanting in honesty, disposed to cheat or defraud; thievish.
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> "Dishonest" is a word of such common use that I should not have thought that it could give rise to any serious difficulty, but in construing even plain words regard must be had to the context and circumstances in which they are used: . . . However, to try to put a gloss on an old and familiar English word which is in everyday use is often likely to complicate rather than to clarify. "Dishonest" is normally used to describe an act where there has been some intent to deceive or cheat. To use it to describe acts which are merely reckless, disobedient or foolish is not in accordance with popular usage or the dictionary meaning. It is such a familiar word that there should be no difficulty in understanding it. . . .
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> . . . I am strongly of the opinion that it would be contrary to both principle and authority to make a finding of dishonesty against Cooper when I am satisfied on the evidence he has not been guilty of any bad faith, any intentional deception or concealment or any conscious wrongdoing. . . . Unless bound to do so by unquestionably binding authority, I would not be prepared to give "dishonest" a meaning in this context which would require the Court to characterize an act as dishonest when it is satisfied that there has been no intentional wrongdoing or deception.

To a similar effect, the court in *Irvin Jacobs & Co.* v. *Fidelity & Deposit Company of Maryland*, 202 F. 2d 794 (U.S.C.A., 7th Cir. 1953, Ill.) stated at 798 that the acts of an employee resulting from his mere negligence, mistake, error in judgment, or incompetence, cannot be characterized as "dishonest" within the meaning of a broker's blanket bond insuring against loss through employee's dishonest or fraudulent acts, but that the employee need not personally profit by his acts before they can be said to be "dishonest".

In *R.* v. *Ghosh*, [1982] 2 All E.R. 689 (C.A.) at 696, Lord Lane, C.J. enunciated a two-tiered test for determining when conduct is criminally dishonest. The first step, which addresses the act itself, was stated as follows:

> . . . [a] jury must first of all decide whether according to the ordinary standards of reasonable and honest people what was done was dishonest. If it was not dishonest by those standards, that is the end of the matter. . . .

Ordinary standards are not to be confused with the highest standards. In *R.* v. *Doren* (1982), 135 D.L.R. (3d) 258 (Ont. C.A.) Dubin, J.A. stated at 262-263:

> I agree with counsel for the appellant that it cannot be said that in every case where the trier of fact determines that conduct falls below the highest standard of straightforward or honourable dealings that that finding alone would be sufficient to make out a case of fraud or conspiracy to defraud. I think that imposes too high a standard against which to measure criminality.
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> A person's business conduct or ethics may fall short of being of the highest standard of straightforward or honourable dealings and yet it could not be said that such a failure would constitute a crime in every case. . . .

Ewart, *Criminal Fraud* (1986) (hereafter "*Ewart*") sets out the main, but not all, categories of dishonesty as they have been identified in recent cases in the context of criminal fraud as follows at 81-95:

1. The use of corporate funds for personal purposes and not for *bona fide* corporate purposes;
2. Non-disclosure of material information;
3. Exploiting weaknesses;
4. Diversion of funds without authority;
5. Unauthorized use of money or property for one's own benefit to which someone else is entitled.

This outline will consider each of these categories in turn.

(i) *Use of Corporate Funds for Personal Purposes*

Ewart states at 81-82 that ". . . while it is normal and perfectly legal for directors to risk company assets for corporate purposes, it is dishonest if the same risk is taken not in the *bona fide* interests of the corporation, but in the personal interests of the directors. . . ."

Olan was concerned with the use of corporate assets. The facts in *Olan* are summarized in the S.C.R. headnote as follows:

In late 1971 Langley's Limited, a long-established dry-cleaning enterprise in Toronto, owned a substantial portfolio of "blue-chip" securities valued at $1,443,460. The control of the company, some 90 per cent of the common shares, was held by two estates and an individual represented by a chartered accountant, Leonard Johnston. Mr. Johnston was approached by one of the accused, Olan, President of First Montreal City Corporation Limited, to discuss the purchase of the controlling shares. It was agreed that the controlling common shares and certain preferred shares of Langley's would be acquired by First Montreal for approximately $1,485,000 payable in cash. Toward the end of the negotiations Mr. Johnston also met the other accused Hudson, President and Director of Beauport Holdings, and Hartnett, Vice-President and Director of Beauport Holdings and legal adviser to Hudson. Before closing First Montreal assigned its rights under the agreement to Beauport. Thereafter Hudson and Hartnett played the dominant roles aided by Olan who was to receive a finder's fee of approximately $67,000 for negotiating the sale. As at November 30, 1971 the total current assets of Beauport Holdings were $149,968.30 and the total assets $738,966.87. The closing date for the purchase of the Langley's shares was to have been December 2, 1971, but, as the purchasers did not have the necessary money, was postponed. A series of financial manoeuvres followed. A bank account had been opened in name of Beauport Holdings on December 8, 1971, and the accused met with the bank manager concerning the certification of a cheque for $1,025,000 to be drawn on the account. There were no funds in the account but the manager was advised that a deposit of $488,000 was available and would be deposited later the same day. At a second meeting the manager agreed to the certification but only on condition — he was to be present at the closing and retain possession of the cheque until the purchase of Langley's was completed, when the accused would take possession of Langley's portfolio, sell the securities and with the proceeds cause Langley's to buy another company owned by them. On December 10, 1971, the accused completed through Beauport Holdings the purchase of approximately 90 per cent of Langley's common shares; the preferred shares were purchased later. The vendors received the certified cheque for $1,025,000 drawn on the account of Beauport Holdings plus $246,545 being the proceeds of a loan to Beauport Holdings.

Another company, Beauport Financial Corporation Limited, had been incorporated by Hudson and Hartnett on November 23, 1971. Immediately after the purchase of the Langley's shares a meeting of the new Board of Directors of Langley's was convened which authorized the sale of all securities owned by Langley's, the purchase of 11,000 shares of Gibraltar Mines Ltd. for $49,500, the purchase from First Montreal of the outstanding shares of a Quebec company, Advertising Associates, for $400,000, and the subscription by Langley's for 10,000 shares in Beauport Financial at $10 per share. Further steps were taken and as a result Beauport Financial received from Langley's $790,000 which it loaned to Beauport Holdings to complete by Beauport Holdings the purchase of Langley's. The issues were whether the $790,000 was expended in furtherance of the *bona fide* business interests of Langley's, or merely in advancing the personal interests of the accused, and whether Langley's suffered deprivation as a result of this action. The accused were tried and convicted of defrauding Langley's of money and valuable securities to a value of $1,190,000 contrary to s. 338 of the *Criminal Code*, however the Court of Appeal set aside the conviction. Leave was granted to appeal to the Supreme Court on the question as to whether the Court of Appeal had erred in holding that there was no evidence of fraud to go to the jury and in its consideration of the applicability and scope of the principles of law in *Cox and Paton* v. *The Queen*, [1963] S.C.R. 500, as they related to each accused.

The Supreme Court of Canada overturned the Ontario Court of Appeal and in the course of doing so restated the law of criminal fraud.

With respect to the use of corporate assets, Dickson, J., delivering judgment for the court, stated at 1182:

> Using the assets of the corporation for personal purposes rather than *bona fide* for the benefit of the corporation can constitute dishonesty in a case of alleged fraud by directors of the corporation. . . .

The learned judge continued at 1191:

> . . . It was open to the jury to ask this question — what possible legitimate business reason could have prompted the disposal by Langley's of a portfolio of high quality securities and, in effect, the substitution therefor, as to $790,000, of unsecured demand promissory notes of a company with a working capital deficit of over $1,100,000 and over which company Langley's had no control?

And at 1194:

> . . . it was proper for the judge at trial to leave it to the jury to decide whether the respondents honestly believed that the disposal of the portfolio and re-investment of the proceeds was in the best interests of Langley's. . . .

In *R.* v. *Sinclair*, [1968] 3 All E.R. 241 (C.A.), leave to appeal to the House of Lords denied [1968] 1 W.L.R. 1251n, cited with approval in *Olan*, the court upheld convictions where the accused involved had used corporate assets in a manner which was not in the best interests of the company. The court stated at 246:

> To cheat and defraud is to act with deliberate dishonesty to the prejudice of another person's proprietary right. In the context of this case the alleged conspiracy to cheat and defraud is an agreement by a director of a company and others dishonestly to take a risk with the assets of the company by using them in a manner which was known to be not in the best interests of the company and to be prejudicial to the minority shareholders.

The learned judge went on to state at 1251 that:

> The important and simple question for the jury to decide . . . was whether they could have thought that a board of directors acting honestly would have agreed to the course which was taken in this case with the assets [of the company in question]. . . .

In *R.* v. *Marquardt* (1972), 6 C.C.C. (2d) 372 (B.C.C.A.) the accused's argument that the company was his alter ego, and that at worst the transactions amounted to transferring *his* money from one pocket to the other, was rejected. The court stated at 374:

> . . . Even if this company were a "one-man company" owned and controlled by the appellant, he had no right to deplete the assets of the company and thus prejudice the rights of creditors. . . .

In *R.* v. *Shaw* (1983), 4 C.C.C. (3d) 348 (N.B.C.A.) the accused argued that he had acted in an indiscreet or stupid manner in making a temporary loan to himself in order to facilitate a legitimate investment. Dismissing the accused's appeal the court stated at 352-353:

> . . . It was the means of obtaining the money from his company which constituted the basis of the fraud charge, not his ultimate use of the money. . . .
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> . . . the instructions of the trial judge clearly identified the issue the jury had to decide, which was whether the means employed by the appellant to obtain the money from his company could be stigmatized as dishonest and detrimental to the economic interest of the company. . . .

In *R.* v. *Black and Whiteside* (1983), 5 C.C.C. (3d) 313 (Ont. C.A.), leave to appeal to S.C.C. refused 52 N.R. 153, the accused, under pressure from his bankers, transferred monies from public companies he controlled either for his own use or for the benefit and use of his private companies. The funds were initially transferred without any security being given and without authorization. The accused later restructured the transactions so as to provide security. The accused asserted in his defence that not only was he entitled to make the transfers, but the transfers had in fact been made openly. The court in dismissing the accused's appeal noted that the trial judge had paraphrased, in part, the decision in *Olan*, and ruled at 319 as follows:

> Here, in light of the charge and jury's finding, there can be no doubt that the jury would have found that what he was doing was dishonest according to the ordinary standards. The issue left with the jury was whether the accused took moneys from the public sector companies not for the benefit of those companies, but in his own interests. Obviously the jury found against the accused on this issue. . . .

In *Attorney General's Reference (No 2 of 1982)*, [1984] 2 All E.R. 216, 78 Cr. App. R. 131 (C.A.) (sub nom. *A.G.'s Reference (No. 2 of 1982)*) the two accused diverted substantial sums of money, for personal purposes, from companies of which they were the sole owners and shareholders. In their defence, the accused argued that they could not have acted dishonestly since they must have consented to the use of the funds in their capacity as the sole directing minds and will of the companies. The issue on reference by the Attorney General was whether a person in total control of a limited company was capable of stealing property belonging to the company. The Court of Appeal held at 222 of All E.R.:

> . . . The basic fallacy in the submission on behalf of the defendants is the contention that, in effect, in a situation such as the present a jury is bound to be directed that, when all

> the members and directors of a company act in concert in appropriating the property of their company, they cannot, as a matter of law, be held to have acted dishonestly, or that, on such facts, any reasonable jury is bound to reach this conclusion. We entirely disagree with both these propositions. . . .

The court, at 223 of All E.R., adopted the following statement of Buckley, L.J. in *Belmont Finance Corp. Ltd.* v. *Williams Furniture Ltd.*, [1979] 1 All E.R. 118 (C.A.) at 125-126:

> . . . [The knowledge of the directors] should not be imputed to the [company], for the essence of the arrangement was to deprive [the company] improperly of a large part of its assets. As I have said, the [company] was a victim of the conspiracy. I think it would be irrational to treat the directors, who were allegedly parties to the conspiracy, notionally as having transmitted this knowledge to the [company]. . . .

Subsequent to the decision in *Olan*, the House of Lords in *R.* v. *Chief Metropolitan Magistrate; ex parte Tarling* (1977), 70 Cr. App. R. 77 cast doubt on the validity of the earlier English decisions upon which the Supreme Court of Canada relied in *Olan*. *Olan* was decided on May 30, 1978; *Tarling* was decided on April 19, 1979. The court in *Tarling* indicated that not every improper act in relation to corporate assets is necessarily dishonest.

In *Tarling*, an English investment firm took over a Singapore company through which it made a number of investments in Hong Kong companies. It was alleged that the directors of the Singapore company had defrauded the company by illegally allocating to themselves some of the windfall profits of the investments in the Hong Kong companies. It was also alleged that the directors had defrauded the public by causing the company's share of the windfall profits to be disguised in a way that would create a false picture of steady growth over a number of years, to induce the public to invest. The Singapore government had requested the extradition of Tarling, who was a director of one of the Hong Kong companies, and Slater, who, while not a director of one of the Hong Kong companies, was unquestionably in charge of the corporate empire of which the Hong Kong companies were a part. The Magistrate dismissed all charges against Slater on the basis that he was not a director of the Hong Kong companies. In dismissing charges of theft, fraud and misleading the public against Tarling, Wilberforce, L.J. stated at 110:

> Certain comments on the Spydar transactions are unavoidable, and were indeed made by the Divisional Court. Even allowing for the psychology of the time, and for the fact that they seem in some form or another to have been current in the Slater, Walker Group as a whole, they were hardly commendable by any standards. Further, they would appear, *prima facie*, to amount to a case of persons in a fiduciary capacity making a secret profit at the expense of their companies — conduct for which there exist classical remedies in equity. . . . Breach of fiduciary duty, exorbitant profit making, secrecy, failure to comply with the law as to company accounts (I state these as assumptions) are one thing: theft and fraud are others. . . .
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> . . . The highest, in my opinion, that the evidence can be put is that the participants made a secret profit . . . and that they kept it secret: it would not otherwise be a secret profit. This by itself is no criminal offence whatever other epithet may be appropriate. They omitted to disclose it, in breach, it may well be, of a fiduciary duty, although a number of occasions arose when they could have disclosed it. They might have been a breach of the Singapore Companies Act as regards non-disclosure . . . but charges to this effect have failed on jurisdictional grounds so a conspiracy to commit these same alleged breaches could not be triable in Singapore/England. None of this, in my opinion, amounts to a case of the convoluted conspiracy to defraud which is alleged and . . . it is not possible for the Government of Singapore to go outside the particulars of the alleged offence which, as it is required to do, it provided; and which were included in the authority proceed. . . .

He went on to observe at 112:

> . . . [The Divisional Court] also found that "on the evidence adduced, Mr. Tarling's complicity appears to us to derive from errors of judgment and [his] exercise of a too intermittent and remote control rather than from any dishonest intention." A review of the extensive documentation on this matter has satisfied me that this finding is correct. . . . He was careful to act throughout in accordance with expert advice from accountants and solicitors. This may not exempt him from his statutory liabilities but surely helps to negative any case of fraud. . . .

The court in *R.* v. *Loewen*, unreported, (September 13, 1982, B.C. Co. Ct.) dismissed theft and fraud charges against the accused who controlled a group of private corporations known as the All-Fun Group. Over a period of time he transferred assets among the corporations within the group prior to one of the corporations going bankrupt. The prosecution alleged that a number of transactions by the accused were fraudulent in that they were the result of the accused's intention to dishonestly deprive the corporations.

In one of the transactions, the prosecution alleged that the accused advanced a loan from C & C Transportation to its parent corporation, All-Fun International, at a time when All-Fun International was financially insolvent, so as to constitute an act of fraud upon C & C Transportation and its creditors. The accused contended that the loan to All-Fun International was necessary for that corporation's financial survival. The court recognized that it is sometimes necessary in parent-subsidiary relationships for the subsidiary to assist the parent corporation when the parent corporation is suffering substantial financial losses, as it is in the interests of the subsidiary, as well as the parent corporation, that the parent corporation remain financially viable. Wong, Co. Ct. J. stated at 26-28:

> In relationships between subsidiary and parent companies, it is sometimes necessary for a subsidiary company to assist its parent, whenever the parent is in financial difficulty. In this case, it was in the interest of C & C Transportation, as well as to All-Fun, to keep the parent company financially viable, as there were inter-company debts owed by All-Fun to C & C Transportation.
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> Unless there is leakage of corporate assets for personal benefit of common directors, . . . the mere transfer of assets from one company to another company at risk is insufficient to infer fraud. The question here is, was there a legitimate business purpose in transferring assets from C & C Transportation to benefit All-Fun?
>
> All accused testified that there was no contemplation of wrongful gain in the transfer of funds, and that it was their intention, at all times, to keep the business of All-Fun alive. There is documentary evidence to substantiate that the accused had plans to continue the operation of All-Fun. Monies were therefore borrowed, in part, from personal funds of the accused, and the balance from borrowed funds pledged by the accused to a bank. The accused became personally liable to the bank for most of these monies. Under these circumstances, I do not think the injection of funds from C & C Transportation to All-Fun was improper. . . .

The prosecution also alleged that the accused stripped an asset from All-Fun International, just prior to its bankruptcy. The court found that the accused had a vested interest in ensuring that All-Fun International remained financially viable and that he intended to carry on its operations beyond the date of the bankruptcy. The court also found that there was a valid business reason for the transaction which was not affected by the fact that the accused ultimately made a profit on the transaction. Wong, Co. Ct. J. summed up the transactions as follows at 45-46:

> Throughout this trial, the overall Crown theory was that the accused were engaged in a concerted plan to take assets out of the All-Fun enterprise before it collapsed. I have said earlier that some transactions were suspicious and gave some support to the Crown's theory,

> but that on closer examination, fraudulent actions by the accused were not conclusively established.
>
> • • • • •
>
> These actions by the accused, to further or to protect the interests of their group, on reflection, were unnecessary and caused considerable confusion in sorting the evidence relevant to the issues. Ultimately, I came to the conclusion that these actions were isolated examples of the imprudent acts by the accused to meet emergent difficulties, rather than any concerted action to plunder corporate assets.

(ii) *Non-Disclosure*

Ewart's second category of dishonesty in this context, listed at the outset above, is non-disclosure of material information. *Olan* makes it clear that non-disclosure of material information falls within the definition of dishonesty. The law in this area is analogous to the civil law concerning when silence may equate to a representation of fact, as considered above.

In *R.* v. *Wagman* (1981), 60 C.C.C. (2d) 23 (Ont. C.A.) the accused developer induced the mortgagee to advance the remaining 25% of mortgage funds by submitting agreements of purchase and sale entered into, not by genuine customers but rather, by employees and friends of the accused. The precondition to the release of the remaining 25% of the mortgage funds was that the houses in question be sold. The Ontario Court of Appeal stated at 30:

> The making by the appellant of a representation [by submitting the agreements of sale] that the properties were sold to the named purchasers, without disclosure to . . . [the mortgagee] that the purchasers were at best acting as trustees for . . . [the accused's company], constituted sufficient grounds upon which the trial Judge could make a finding of dishonesty on the part of the appellant. . . .

In *R.* v. *Cote* (1982), 3 C.C.C. (3d) 557 (Que. C.A.) the accused sought to cash stolen bonds. Owen, J.A. stated at 563:

> Proof that the respondents agreed and attempted to present the bearer bonds for redemption without disclosing a fact of which they were aware, namely, that the said bonds were stolen, would be sufficient in law, to support a conviction on counts 2 and 3 [conspiracy to defraud and attempted fraud].

L'Heureux-Dube, J.A., in one of three concurring judgments in that case, stated at 565 and 567 (translation):

> The fraudulent manoeuvres and other fraudulent means can be in the nature of "mere non-disclosure" or omissions and need not necessarily be positive acts. . .
>
> • • • • •
>
> . . . With respect to the issue of fraudulent means, the sole fact that the respondent knew that they were dealing in stolen bonds, and that they did not reveal this fact constitutes dishonest means . . .

R. v. *Zaritec Industries* (1975), 60 D.L.R. (3d) 98 (Alta. C.A.), leave to appeal to S.C.C. denied 24 C.C.C. (2d) 180n, overturned the accused's conviction for defrauding house purchasers by accepting deposits for pre-fabricated houses and failing to deliver them. The corporation accepted three times as many orders as it could handle and ran out of the necessary cash flow to maintain construction. Although the accused had taken a significant amount of cash from the corporation, he also injected over $10,000 in cash and personally guaranteed a loan to the corporation one month before the corporation ceased business. He also attempted to negotiate a $75,000.00 loan for the corporation and returned a cheque for a deposit that had been received one month before the corporation ceased business. Allen, J.A., after considering the accused's lack of personal profit and his apparent monetary loss from the venture, found at 118 that these facts fell short of fraud.

In *R.* v. *Seed*, unreported (March 27, 1986, No. CC850884 B.C. Co. Ct.) Boyd, Co. Ct. J. accepted a familiar line of defence, stating as follows at 23:

> In all of these circumstances, and bearing in mind the defendants' apparent inability to understand or manage their own company's affairs, I am satisfied that the defendants could have actually believed that [the company's] financial success was realistically within reach. Such a belief was naive, misguided, and perhaps even a reflection of incompetence or carelessness on their part. But even if that is the case, their actions, in my opinion, still fall short of the conduct which would constitute fraud.

(iii) *Exploiting Weaknesses*

In cases of dishonesty involving the exploitation of weaknesses, Ewart's third category, the means used are not necessarily dishonest in the abstract, but may become dishonest when employed so as to take advantage of a particular condition, infirmity or even the carelessness of the victim. Before *Olan*, cases in which there was held to be exploitation of an individual's weakness included taking advantage of: an elderly person in *R.* v. *Hilliard Palmateer* (1975), 28 C.C.C. (2d) 566 (Ont. Co. Ct.); unskilled investors in *R.* v. *Rodrigue, Ares and Nantel* (1973), 17 C.C.C. (2d) 252 (Que. C.A.); senility in *R.* v. *Kribbs*, [1967] 2 O.R. 539 (C.A.); youth or lack of business experience in *Vincent* v. *R.* (1952), 16 C.R. 249 (Que. C.A.).

In the pre-*Olan* decision of *R.* v. *Rodrigue, Ares and Nantel*, *supra*, the appellants were the president, general manager and the sales manager respectively of a company which sold building lots to private individuals by way of an intensive advertising campaign, which included door-to-door selling by salesmen of tickets, ostensibly to a wine and cheese meeting, but really to a sales meeting. The tickets made no mention of the sale of lands. At the meeting, emphasis was placed on the eventual profits to be obtained because the lands in question would definitely be worth ten times as much in five years, due to anticipated industrialization. Salesmen presented offers for sale for the signatures of those present and every persuasive tactic was used. After signing an offer for sale, the buyer could visit his land but it was subdivided only on paper and particular parcels were not identifiable. Further, the statements made concerning the anticipated industrialization were false and the appellants knew them to be false. Finally, the defence led evidence that the land at the time of the sales had the value paid for it by the purchasers. The accused were convicted of conspiracy to defraud and appealed.

In dismissing the appeals the court held that the tickets, with the purposeful omission, constituted a deceit and that the land was sold at a reasonable price was not a defence, since it was sold on the basis of false representations as to the future potential of the land and the buyers were thereby cheated. The acts and conduct of each of the appellants in demonstrating their knowledge of the real situation with respect to the land, and their cooperation in the sales meeting and subsequent sales permitted the inference of requisite agreement and, therefore, conspiracy on their part. The court at 270 made specific mention that "the people who [fell] into the trap were little informed people in matters of investment who were easy prey".

In *R.* v. *Hansen* (1983), 25 Alta. L.R. (2d) 193 (C.A.) the accused successfully negotiated a cheque notwithstanding that she knew that a stop payment order had been issued. The court held that while the bank's error and lack of alertness may have made the deprivation possible, this did not detract from the accused's dishonesty.

Ewart cites an unreported decision of the British Columbia Court of Appeal which considered the fundraising efforts of a company which was on the brink of financial collapse. The case is *R.* v. *McGuire*, [1983] B.C.W.L.D. 1228 No. CA 821158, May 3, 1983. *Ewart* at 89-90 describes the case as follows:

> . . . the accused, having serious cash flow problems in his business, obtained sums of money in return for promissory notes which he had no realistic hope of being able to repay.

> He had issued the promissory notes in the name of one company on the same day that he had been ordered to cease selling promissory notes in the name of another of his companies. The funds received were almost immediately disbursed to other ventures and personal ends.
>
> In reaching its decision, the majority of the court noted that it was obvious that the investors "had the impression" that they would receive their investment back, together with the very healthy rate of return which had been promised. As well, based in some instances on a perusal of a draft prospectus which had been presented, they could assume that they were dealing with a financially sound company. However, none of the investors appeared to be particularly cautious in making the investment. [It was noted that none of the four investors appeared to appreciate the significance of the prospectus or to place much weight on it. One read only the first page, while another even made his investment after making his own inquiries of the office of the Superintendent of Brokers and finding out that the prospectus had not been approved.]
>
> . . . the majority upheld the fraud conviction, saying:
>
>> McGuire must have known that the Investment Corporation could not possibly meet its commitments to the four investors, either in the immediate future or at anytime in the future.
>
> The non-disclosure of this fact to the investors, plus the fact that McGuire had good reason to believe that his solicitation of funds from the public through promissory notes was forbidden, was sufficient to constitute dishonesty, notwithstanding the apparent carelessness of the victims. [On the same day he issued the prospectus in question, McGuire had been directed to stop issuing promissory notes through another of his companies. As the court noted, he accordingly took steps to do through the second company the very thing which he had been told he could not do, namely solicit funds from the public in return for promissory notes.]

(iv) *Diversion of Funds*

Diversion of funds without authority, Ewart's fourth category of dishonesty, was the basis of the decision in *R.* v. *Currie*; *R.* v. *Bruce* (1984), 5 O.A.C. 280 (C.A.) which upheld a fraud conviction where funds invested for specific purposes were diverted to unauthorized investments. The court held that the dishonesty consisted of deliberately going outside the scope of the authority granted by the investors.

The defendant Currie operated a financial consulting and professional management service through a company. Bruce was the chartered accountant who, among other things, through his company, provided bookkeeping, accounting and managerial services for Currie and his company. Currie solicited investments in a factoring scheme whereby the accounts receivable of a product known as "Water-Eze Products Ltd." would be purchased at a 5% discount, revolving the $100,000 investment eight or nine times a year for a substantial profit. Bruce was to be responsible for supervision of the collections and was the trustee for the investors.

Funds that had specifically been invested for the Water-Eze factoring were diverted, without notice to the investors, to an aviation company located in Quebec and were eventually lost. Bruce was said to have aided and abetted this fraudulent scheme. Currie was also charged with fraud in relation to the $35,000 investment by another investor in which the purchase of an aircraft was represented as a tax shelter. Finally, Currie was also charged with fraud where another group of seven investors were allegedly defrauded through a solicitation of some $35,000 for investment in another aircraft for tax advantages. The aircraft was later sold for a net loss on the investment.

Counsel for Currie acknowledged that his client, a professional investment counsellor, may have used the clients' investment funds in a manner which was not expressly authorized, but he asserted that Currie had an implied general discretionary power to invest funds. In the alternative, he argued that Currie entertained an honest, *albeit* mistaken belief that he was authorized to invest the money as he saw fit, subject to his obligation to seek validation or ratification of the investments *ex post facto*. The court found that the investors had responded to a very specific investment proposal.

The court noted that the trial judge had correctly charged the jury with respect to the elements of fraud. It quoted passages of the jury charge as follows at 283:

> As long as the conduct of a person towards the alleged victim involves some element of dishonesty, which to some significant extent causes deprivation of the victim, this will constitute fraud. In many cases a person will cause the deprivation of another by making both true and false representations. The offence of fraud is committed if the representations which are false are the effective, although not the exclusive, cause of the deprivation. Similarly, where a representation is made to a person who, over time, parts with property as a result of that representation, failure to advise the individual of a change in circumstances which makes the representation false will turn the representation into the offence of fraud.

Having approved the trial judge's charge, the court at 284 cited *The Queen* v. *Lemire*, [1965] S.C.R. 174, where the accused was charged with having defrauded the public through the submission of fictitious expense accounts, and stated: ". . . we take it as settled law that an honest belief that a fraudulent act may be subsequently ratified is not a valid defence to a charge of fraud . . . ".

(v) *Arrogation of Money or Property*

Ewart's fifth category involves the arrogation of money or property. In *R.* v. *Renard* (1974), 17 C.C.C. (2d) 355 (Ont. C.A.) the accused deceived a customer of his employer into paying to him money owing to the employer. While no deceit was used *vis à vis* the employer, who was the alleged victim of the offence, the judgment held that the accused's "dishonest obtaining" of the cheque from a third party and his "dishonest dealing with it" constituted the fraudulent means required to establish the offence of defrauding his employer.

Similarly, *R.* v. *Kirkwood* (1983), 42 O.R. (2d) 65 (C.A.) held that the accused acted dishonestly when he sold and rented "pirated" videotapes of movies when he knew that he had no right to profits from such activities and that he was depriving the owners of the films of revenue.

R. v. *Davis*, [1978] 6 W.W.R. 442 (B.C. Co. Ct.) held that it was dishonest for a cabinet minister to retain funds obtained which represented the differential between the cost of travel on government business in economy rather than first class. The cabinet minister was convicted of fraud. It was argued that because the minister was entitled to claim the cost of first class airfare, he ought to be able to retain any money saved by travelling in economy class. The trial judge rejected this argument at 448 and stated:

> As a matter of practice rather than by regulation or order in council, it would appear that the cost of first class air transportation is considered reasonable for cabinet ministers, and a minister may choose to travel that way. But he may choose or he may be obliged to fly economy class or to travel by taxi, bus, rail, ferry or even, as suggested by the evidence, by government jet aircraft. For such travel, he will be compensated for or allowed whatever reasonable sum he was obliged to pay in fact, and he is entitled to no more.
>
> The government of the province of British Columbia paid to or on behalf of the accused the amounts shown on the various expense accounts in issue. As the accused was not entitled to any refunds which were made by the airlines involved, it surely cannot be suggested that the refunds were not at law the property of the government.

Summary of the Law on "Dishonesty"

Ewart suggests at 92 and 93 that the following principles may be extracted from the cases:

1. All means used to obtain or to attempt to obtain something to which an accused was not entitled can be characterized as dishonest;

2. Breach of a position of trust or quasi-trust will afford evidence of dishonesty;
3. Taking advantage of the weakness or gullibility of another in order to inflict economic deprivation can constitute dishonest means in the law of fraud.

Ewart states at 95 that "these three basic concepts — obtaining something to which there is no entitlement, misusing a position of trust or responsibility, and taking advantage of the weaknesses of another — . . . are the cornerstones of the concept of dishonesty in the new law of fraud . . . ".

(b) *Deprivation*

Dishonesty and a corresponding deprivation are essential to criminal fraud. In the period before *Olan*, deprivation was generally held to be a loss of a tangible right or benefit. However in *Olan*, the concept was developed significantly. In *Olan* Dickson, J. stated as follows at 1182:

> The element of deprivation is satisfied on proof of detriment, prejudice, or risk of prejudice to the economic interests of the victim. It is not essential that there be actual economic loss as the outcome of the fraud. The following passages from the English Court of Appeal judgment in *R.* v. *Allsop* (1976), 64 Cr. App. R. 29, in my view correctly state the law on the role of economic loss in fraud, at pp. 31, 32:
>
>> Generally the primary objective of fraudsmen is to advantage themselves. The detriment that results to their victims is secondary to that purpose and incidental. It is "intended" only in the sense that it is a contemplated outcome of the fraud that is perpetrated. If deceit which is employed imperils the economic interest of the person deceived, this is sufficient to constitute fraud even though in the event no actual loss is suffered and notwithstanding that the deceiver did not desire to bring about an actual loss.
>>
>> We see nothing in Lord Diplock's speech [in *Scott*] to suggest a different view. "Economic loss" may be ephemeral and not lasting, or potential and not actual; but even a threat of financial prejudice while it exists it may be measured in terms of money. . . .
>>
>> Interests which are imperilled are less valuable in terms of money than those same interests when they are secure and protected. Where a person intends by deceit to induce a course of conduct in another which puts that other's economic interests in jeopardy he is guilty of fraud even though he does not intend or desire that actual loss should ultimately be suffered by that other in this context.

In *R.* v. *Kirkwood*, *supra*, the accused was recording and marketing pirated copies of movies. Deliberate dishonesty was present but there was no obvious victim. The court upheld the conviction of the accused on the basis that the holders of the copyright and distribution rights were deprived of potential profits resulting from the expected loss of sales of legitimate copies of the movies. The decision in *Kirkwood* was followed in *R.* v. *Fitzpatrick* (1984), 11 C.C.C. (3d) 46 (B.C.C.A.).

In *R.* v. *Wagman*, *supra*, a second installment on a mortgage was advanced. To meet a condition requiring executed agreements for sale for all the existing houses he had developed, the accused acted dishonestly in failing to disclose the fact that the purchasers purchased as trustees for him or his company. However, the properties were all later sold to *bona fide* purchasers and the funds advanced were completely recovered. The court held that the premature advance of the second installment created a potential risk of loss of this amount and, as such, constituted deprivation.

The third category of deprivation is not as well established as the other two. In *R.* v. *Knowles* (1979), 51 C.C.C. (2d) 237 (Ont. C.A.) the accused was president of a company which franchised hardware stores and, as such, was prohibited from operating a franchise himself. The accused created a corporation to operate a franchise and secured a loan from his parent company for the corporation. While the loan was totally secure and never in risk of loss, the company was induced into making the loan under circumstances which, if known, would have precluded the loan. Martin, J.A. writing for the court held that "In those circumstances the dishonest deprivation consists of inducing the complainant to its detriment to make the loan which it would not have made if it had not been deceived as to the true state of affairs." He explained that the fact that no economic loss resulted goes to the matter of the penalty only.

Similarly *R.* v. *Knelson and Baran* (1962), 133 C.C.C. 210 (B.C.C.A.), a decision pre-dating *Olan*, upheld the conviction of the accused for knowingly making false representations that oil had been discovered on lands owned by a certain oil company, thereby inducing persons to purchase stock. The appellants had contested the conviction on the ground that there was no proof of economic loss by the purchasers. Wilson, J. writing for the court held that to defraud does not require that a victim be deprived of an economic advantage or suffer an economic loss. The court held at 214 that the purchasers here were defrauded "because the thing they paid their money for had not the attributes mendaciously ascribed to it by the appellants".

While there need not be an economic loss, there must be an actual risk of prejudice to the economic interests of the alleged victim. In *Vezina* v. *The Queen*, [1986] 1 S.C.R. 2 the accused deposited stolen Bank of Canada bearer bonds with the Bank of Montreal for the account of a Swiss bank. The Bank of Montreal and the Bank of Canada learned that the bonds were stolen and did not credit the Swiss bank with the proceeds of the bond. The accused were charged with conspiracy to defraud and attempting to defraud the Bank of Montreal. The trial judge directed a verdict of acquittal on both counts as there was not any evidence that the Bank of Montreal would have been deprived of anything even if the accused had successfully carried out the transaction. The Bank of Montreal only had to receive the bonds, turn them over to the Bank of Canada to cash them and credit the proceeds to the Swiss bank. This transaction would not in any way prejudice the Bank of Montreal. The trial judge's direction was upheld by the Supreme Court of Canada. Lamer, J. stated at 21:

> As wide as the notion of deprivation may be, I do not see it as encompassing the kind of prejudice to the Bank of Montreal that that Bank could have incurred. Any deprivation to the Bank of Montreal would be speculative and too remote. . . .
>
> • • • • •
>
> . . . as regards the Bank of Montreal, there is no such identifiable risk of economic prejudice. The Bank of Montreal was not being asked to part with anything it owned, possessed or had any special interest in.

In *R.* v. *Campbell and Kotler*, [1986] 2 S.C.R. 376 with respect to the same issue, Lamer, J. stated at 385:

> . . . While it is not essential for a victim to be defrauded "of any property, money or valuable security", "that there be an actual economic loss as to the outcome of fraud" . . ., there must nevertheless be an actual "risk of prejudice to the economic interests" of the alleged victim . . . .

See also: *R.* v. *Floris* (1988), 87 A.R. 353 (C.A.); *R.* v. *Stewart*, [1988] 1 S.C.R. 963; *R.* v. *Tucker* (1988), 83 N.S.R. (2d) 6 (N.S.C.A.).

(c) *Mens Rea*

The physical elements of the law of criminal fraud are dishonesty and deprivation. Once it has been determined that the conduct was dishonest and that a deprivation flowed therefrom, it remains to be determined whether the requisite mental element was present.

In general, the mental element requires not only proof that the acts be judged objectively dishonest but also proof that the accused knew the act was dishonest and intended to act dishonestly. The accused's subjective notions of dishonesty are therefore relevant in proving whether the accused had a dishonest intent.

Whether the accused knew the act was dishonest does not require proof of direct personal knowledge in every case. Criminal liability may be imposed, through the doctrines of recklessness or wilful blindness, on those who have a subjective appreciation that the relevant circumstances and consequences probably exist, or whose suspicion about them is aroused but who deliberately refrain from making inquiries in order to avoid acquiring such knowledge.

In *Sansregret* v. *R.*, [1985] 1 S.C.R. 570, a rape case, McIntyre, J. delivering judgment for the court considered the defences of recklessness and wilful blindness in criminal law. At 581 his Lordship explained that:

> The concept of recklessness as a basis for criminal liability has been the subject of much discussion. Negligence, the failure to take reasonable care, is a creature of the civil law and is not generally a concept having a place in determining criminal liability. Nevertheless, it is frequently confused with recklessness in the criminal sense and care should be taken to separate the two concepts. Negligence is tested by the objective standard of the reasonable man. A departure from his accustomed sober behaviour by an act or omission which reveals less than reasonable care will involve liability at civil law but forms no basis for the imposition of criminal penalties. In accordance with well-established principles for the determination of criminal liability, recklessness, to form a part of the criminal *mens rea* must have an element of the subjective. It is found in the attitude of one who, aware that there is danger that his conduct could bring about the result prohibited by the criminal law, nevertheless persists, despite the risk. It is, in other words, the conduct of one who sees the risk and who takes the chance. It is in this sense that the term "recklessness" is used in the criminal law and it is clearly distinct from the concept of civil negligence.

His Lordship stated at 584 with respect to wilful blindness:

> Wilful blindness is distinct from recklessness because, while recklessness involves knowledge of a danger or risk and persistence in a course of conduct which creates a risk that the prohibited result will occur, wilful blindness arises where a person who has become aware of the need for some inquiry declines to make the inquiry because he does not wish to know the truth. He would prefer to remain ignorant. The culpability in recklessness is justified by consciousness of the risk and by proceeding in the face of it, while in wilful blindness it is justified by the accused's fault in deliberately failing to inquire when he knows there is reason for inquiry. . . .

The learned judge held at 587:

> In my view, it was error on the part of the trial judge to give effect to the "mistake of fact" defence in these circumstances where she had found that the complainant consented out of fear and the appellant was wilfully blind to the existing circumstances, seeing only what he wished to see. Where the accused is deliberately ignorant as a result of blinding himself to reality the law presumes knowledge, in this case knowledge of the nature of the consent. There was therefore no room for the operation of this defence.

Lord Sumner writing for the Judicial Committee of the Privy Council in *The Zamora No. 2*, [1921] 1 A.C. 801, on appeal from the Prize Court, England set out an eloquent statement of wilful blindness as follows at 812:

> . . . A thing may be troublesome to learn, and the knowledge of it, when acquired, may be uninteresting or distasteful. To refuse to know any more about the subject or anything at all is then a wilful but a real ignorance. On the other hand, a man is said not to know because he does not want to know, where the substance of the thing is borne in upon his mind with a conviction that full details or precise proofs may be dangerous, because they may embarrass his denials or compromise his protests. In such a case he flatters himself that where ignorance is safe, 'tis folly to be wise, but there he is wrong, for he has been put upon notice and his further ignorance, even though actual and complete, is a mere affectation and disguise.

R. v. *Feely*, [1973] 1 All E.R. 341 (H.L.) is an important case in the development of the modern law of subjective intent. The issue was whether an intent to repay combined with a reasonable belief in the ability to do so was a defence to a charge of theft under the *Theft Act*, 1968. The court stated at 344-345:

> Theft itself is a word known and used by all and is defined, in what the marginal note to s 1 describes as the basic definition, as follows:
>
> > '(1) A person is guilty of theft if he dishonestly appropriates property belonging to another with the intention of permanently depriving the other of it . . .'
>
> These words swept away all the learning which over the centuries had gathered round the common law concept of larceny and in more modern times around the statutory definition of that offence, in s 1(1) of the Larceny Act 1916.
>
> In s 1(1) of the Theft Act 1968 the word 'dishonestly' can only relate to the state of mind of the person who does the act which amounts to appropriation. Whether an accused person has a particular state of mind is a question of fact which has to be decided by the jury when there is a trial on indictment and by the justices when there are summary proceedings. The Crown did not dispute this proposition, but it was submitted that in some cases (and this, it was said, was such a one) it was necessary for the trial judge to define 'dishonestly' and when the facts fell within the definition he had a duty to tell the jury that if there had been an appropriation it must have been dishonestly done. We do not agree that judges should define what 'dishonestly' means.
>
> This word is in common use whereas the word 'fraudulently', which was used in s 1(1) of the Larceny Act 1916, had acquired as a result of case law a special meaning. Jurors, when deciding whether an appropriation was dishonest can be reasonably expected to, and should, apply the current standards of ordinary decent people. In their own lives they have to decide what is and what is not dishonest. We can see no reason why, when in a jury box, they should require the help of a judge to tell them what amounts to dishonesty. . . .

It was held at 346 that ". . . a taking to which no moral obloquy can reasonably attach is not within the concept of stealing either at common law or under the Theft Act 1968."

Whereas the word "dishonestly" is included in the definition of theft in the statute under consideration in *Feely*, it does not appear in any comparable provisions of Canada's *Criminal Code*.

The accused in *R.* v. *Landy*, [1981] 1 All E.R. 1173 (C.A.) were directors of a bank. They were charged with conspiracy to defraud. The particulars of the offence were that the accused conspired together with others to defraud such companies and persons as might lend to, or deposit funds with, the bank by "falsely representing" that the bank's business was being conducted in an honest and proper manner; by knowingly employing the funds "to the prejudice of" lenders and depositors and contrary to the bank's best interests; by fraudulently concealing that the funds were being so employed; "and by divers other false and fraudulent devices." The particulars did not show how the false representations were made, how the funds were employed to the prejudice of the bank and its customers or the nature of the concealment. The judge failed to direct the jury clearly that they had to be sure that the defendants had agreed dishonestly to act in the manner alleged, and treated evidence from which fraud could be inferred as if it were proof of fraud. The defendants were convicted and appealed.

After defining fraud as requiring dishonesty, the court indicated that although the test of dishonesty is subjective in that the jury must consider what the accused believed, the standards of ordinary reasonable persons can be used by the jury in assessing whether the accused actually believed that he was acting honestly. Lawton, L.J. stated at 1181:

> What the Crown had to prove was a conspiracy to defraud which is an agreement dishonestly to do something which will or may cause loss or prejudice to another. The offence is one of dishonesty. This is the all-important ingredient which must be stressed by the judge in his directions to the jury and must not be minimized in any way. There is always a danger that a jury may think that proof of an irregularity followed by loss is proof of dishonesty.

> The dishonesty to be proved must be in the minds and intentions of the defendants. It is to their states of mind that the jury must direct their attention. What the reasonable man or the jurors themselves would have believed or intended in the circumstances in which the defendants found themselves is not what the jury have to decide; but what a reasonable man or they themselves would have believed or intended in similar circumstances may help them to decide what in fact individual defendants believed or intended. An assertion by a defendant that throughout a transaction he acted honestly does not have to be accepted but has to be weighed like any other piece of evidence. If that was the defendant's state of mind, or may have been, he is entitled to be acquitted. But if the jury, applying their own notions of what is honest and what is not, conclude that he could not have believed that he was acting honestly, then the element of dishonesty will have been established. What a jury must not do is to say to themselves: 'If we had been in his place we would have known we were acting dishonestly, so he must have known he was.' What they can say is: 'We are sure he was acting dishonestly because we can see no reason why a man of his intelligence and experience would not have appreciated, as right-minded people would have done, that what he was doing was dishonest.' In our judgment this is the way *R.* v. *Feely*, [1973] 1 All E.R. 341, [1973] Q.B. 530 should be applied in cases where the issue of dishonesty arises. It is also the way in which the jury should have been directed in this case, but, unfortunately, they were not.

The decisions in *Landy* and *Feely* were followed by the Ontario Court of Appeal in 1982 in *R.* v. *Doren*, *supra*. In that case, the accused was charged with fraud and conspiracy to commit fraud as a result of his involvement in a business selling diamonds and emeralds for investment. It was the theory of the prosecution that the accused used several misrepresentations in an effort to sell the diamonds, including misrepresentations as to the marketability of the diamonds sold, the profitability of the investments in diamonds, the security of such investments, the status of the accused's company and the quality of the diamonds sold. The trial judge held that fraud requires proof of a dishonest deprivation and that dishonesty could be defined as "discreditable as being at variance with straightforward or honourable dealings". Having found that many of the misrepresentations alleged by the prosecution had been proven, the trial judge convicted the accused. The accused appealed on the grounds that the trial judge had erred in determining the accused's guilt by measuring his conduct against such a "broad and objective test".

Having reviewed *Feely* and *Landy*, *supra*, Dubin, J.A. reasoned as follows at 262:

> . . . it cannot be said that in every case where the trier of fact determines that conduct falls below the highest standard of straightforward or honourable dealings that that finding alone would be sufficient to make out a case of fraud or conspiracy to defraud. I think that imposes too high a standard against which to measure criminality.

The learned appellate judge continued at 263:

> A person's business conduct or ethics may fall short of being of the highest standard of straightforward or honourable dealings and yet it could not be said that such a failure would constitute a crime in every case. . . .

And at 264:

> The definition of "dishonest" referred to by the trial Judge also appears to make the test a purely objective one whereas intention is an important element of the crime of fraud . . . .

He concluded at 265:

> However, we have the benefit of the findings of fact made by the trial Judge. On the basis of those findings it is not only apparent that the appellant's conduct was discreditable as being at variance with straightforward or honourable dealings, but constituted a conspiracy to defraud when measured against the classic definition of what constitutes fraud by deceit as enunciated by Buckley, J. in *Re London and Globe Finance Corp.*, [1903] 1 Ch. 728 at p. 732.
>
> The trial Judge has found that the public were deliberately lied to and deceived as to three important attributes of the investment that they were making, that the misrepresentations were made with a view to being acted upon and that members of the public did so to their detriment, prejudice or risk of prejudice.

In dismissing the appeal, Dubin, J.A. held at 266:

> The trial Judge's findings, therefore, as a matter of law constituted the offence of conspiracy to defraud, and it is apparent that his conclusion of guilt was not based on the narrow premise that the appellant's counsel urged. Apart from the definition of dishonesty included in the reasons for judgment of the trial Judge, it is apparent that his verdict would inevitably have been the same had that reference been omitted from his reasons, and I would, therefore, dismiss the appeal from the conviction on the count of conspiracy.

In *R.* v. *Currie*; *R.* v. *Bruce*, *supra*, a 1984 case in the Ontario Court of Appeal involving the unauthorized diversion of funds, the accused appealed a conviction of fraud and theft on the grounds that the trial judge's charge failed to leave to the jury for their consideration the accused's only defence — an honest motive and intention to repay the investors. The relevant portions of the trial judge's charge were set out by the court at 283:

> May I also tell you that an intention on the part of the accused to repay the victim is irrelevant and does not provide a defence if the conduct of the accused is otherwise shown to involve dishonest deprivation for personal ends. Similarly, if the victim is deliberately deprived by dishonest means, it matters not that the accused had an honest motive or genuine desire to avoid causing any loss or that he expected that that which he was doing might, at a later time, be validated or rectified or meet with the victim's approval.
>
> Thus, the intent that must be proved is that the accused, by dishonest means, intended to cause deprivation to the victim. As I explained earlier, "deprivation" has a very wide meaning; it occurs upon proof of detriment, injury, prejudice or risk of prejudice to the economic interests of the victim. However, fraudulent or dishonest intent does not require the existence of some evil or reprehensible intention. No distinction is drawn in law between the state of mind of one who does an act because he desires it to produce a particular evil consequence, and the state of mind of one who does the act knowing full well that it is likely to produce that consequence although it may not be the object he was seeking to achieve by doing the act. What is common to both these states of mind is the willingness to produce the particular evil consequence; they connote deliberate conduct. And so, as I stated, if the victim is deliberately deprived by dishonest means, it matters not that the accused had an honest motive or genuine desire to avoid causing any loss.

Dubin, J.A. stated at 283:

> It is argued that this was an erroneous direction which effectively removed from the jury's consideration the only defence available, i.e. honest motive and intention to repay the investors.

With respect to the accused's argument that the accused's honest belief was not left to the jury, the court held at 284:

> In our view, the evidence was fully reviewed and presented to the jury. The real defence on Count 1 charging fraud was the appellant Currie's alleged general authority to invest

> and not his honest belief that he had such power subject to subsequent ratification. We take it as settled law that an honest belief that a fraudulent act may be subsequently ratified is not a valid defence to a charge of fraud. See *R.* v. *Lemire*, [1965] 4 C.C.C. 11, at pp. 32-33.
>
> It is argued that if the appellant honestly believed that he had the authority to invest the funds as he saw fit, the several investments were not fraudulent; and hence, that the principle enunciated in *Lemire*, *supra*, has no application. However, the charge to the jury on the required mental element for fraud was comprehensive and accurate, and it was consistent with binding jurisprudence. See *R.* v. *Olan* . . . and *R.* v. *Wagman* [*supra*]. . . .

The court continued at 284-285:

> In any event, in relation to Count 2, the theft charge which has been quashed, the learned trial judge explained the defence of colour of right and related it to the defence of "honest belief". He said at pp. 31-32:
>
>> The expressions "fraudulently", "without colour of right", and "converted" require some explanation. The word "fraudulently" connotes conduct, which is dishonest or morally wrong. The expression, "colour of right" generally refers to a situation where there is an assertion by the accused of a proprietory or possessory right to the thing which is the subject matter of the alleged theft. When one acts without color of right, he does not believe that he has a right to take or use the property of another. One acts with colour of right when he acts under an honest, genuine misconception of fact or law. Thus, one who is asserting what he honestly believes to be a claim to the subject of the alleged theft cannot be said to act without colour of right, even though his honest belief in the reason why he asserted his claim to the property may be unfounded in fact or law. "Colour of right" is also used to denote an honest belief in a state of facts which, if it actually existed, would at law justify or excuse the act done. Thus, an honest belief that one is entitled to assert proprietory or possessory rights over the property of another, even though that belief be mistaken in law or fact, negatives fraud and would, it follows, negative theft. However, the accused must genuinely believe that he has a lawful claim. The existence of reasonable grounds for an honest belief is a factor for you to consider in deciding whether the belief was honestly held.
>>
>> An accused does not have to establish that he had a colour of right in order to be acquitted. There is no onus on an accused to prove his innocence. He need only, on evidence which you accept, raise the issue and having done so the onus rests on the Crown to negative this defence and to prove beyond a reasonable doubt that the accused acted without colour of right.
>
> This direction clearly stated that an honest, albeit mistaken belief, such as the one asserted here, would negative fraud as well as theft. We find no error in this direction. While it would have been preferable if the direction had been given in the impugned passage in relation to Count 1, we are bound to consider the charge as a whole and avoid criticizing isolated passages.

In *R.* v. *Daigle* (1988), 39 C.C.C. (3d) 542 (Que. C.A.) the court adopted the subjective approach set out in *Landy*, *supra*. Speaking for the majority on this point, Jacques, J.A. stated at 548-549:

> . . . "Dishonesty" can be considered objectively or subjectively. In criminal law, at least in the case of offences in which *mens rea* must be established, it is the subjective aspect which must apply because, were it otherwise, there is a risk that mere stupidity would become a crime.

Criticizing the trial judge's charge to the jury which provided for an objective test, Jacques, J.A. stated at 549:

> The judge therefore did not indicate to the jury that the character of the representations made by the accused must be appreciated not with regard to an objective standard, such as that of the reasonable man, but rather with regard to the state of mind, the intelligence, and the experience, of the accused himself, this factor being appreciated in light of all the evidence.

In *R.* v. *Sebe* (1987), 35 C.C.C. (3d) 97 (Sask. C.A.), the accused and his wife were sole shareholders, officers and directors of Alpha Contracting Ltd. The accused had used proceeds from a Government of Canada taxation refund cheque payable to Alpha for his own purposes and was charged with fraud. The prosecution appealed the trial judge's decision acquitting the accused on the ground that it had failed to prove that the accused acted dishonestly with a deliberate intent to defraud. On appeal, Bayda, C.J.S. citing the decisions in *Olan*, *Landy* and *Doren*, *supra*, stated at 101-102:

> . . . the critical question is whether the "means" constituted by these unauthorized acts were "fraudulent" within the meaning of the section as that term has been interpreted in such cases as *Cox* [*and Patton* v. *R.*, [1963] S.C.R. 500] and *R.* v. *Olan* [*supra*]. . . .
>
> As noted, the Crown alleged that for the means to be fraudulent it is necessary only that the act which constitutes the means be unauthorized or unlawful (i.e. "characterized as dishonest") and that the accused intends to commit that act. The accused agreed that for the means to be fraudulent the act must be unauthorized or unlawful but contended that the mental element has to be more than the mere intent to commit the unlawful act. The intent has to be a dishonest intent.
>
> I respectfully agree with the submissions of the accused in this respect. In my view, there are two aspects of "other fraudulent means". The first is an objective aspect: the means must have an intrinsic quality of dishonesty. . . .
>
> The second aspect of the "means" is the subjective mental component. This component is inextricably bound up with the fourth element of the offence: *mens rea* and they must be considered together. On this crucial point, it is useful to refer to the following passage in [Law Reform Commission of Canada, Theft and Fraud] Working Paper No. 19 . . . at 70:
>
>> 'Code s. 338 [now s. 380] is silent on *mens rea*. The word "defraud", however, implies *mens rea* in two respects. First, the offender has to act intentionally or recklessly — mere carelessness is not enough. Second, we must have dishonest intent: "defraud" is a pejorative term ruling out such things as colour of right. Such dishonest intent is normally implied by proof of intentional or reckless deceit. In complicated and sophisticated frauds, however, *mens rea* may be inferred from evidence of *system* [sic] and similar conduct.' (Footnotes omitted.)

Bayda, C.J.S. quoted with approval from an article by Doherty, "The Mens Rea of Fraud" (1983), 25 Crim. L.Q. 348 at 353 as follows:

> . . . The question must be, "what did this accused know"? A consideration of what any reasonable person in his place would have known, while helpful to the trier of fact in determining what the accused knew, is not the ultimate test by which criminal liability is measured.

Chief Justice Bayda at 102:

> The author made these comments in relation to a statement or representation (which is the normal basis for a deceit or falsehood), but they apply analogously, and with the same force, to an act (which is often the basis for "other fraudulent means"). It would be totally unacceptable to have one state of mind applicable to "deceit" and "falsehood" and another state of mind applicable to "other fraudulent means". For an accused to be criminally culpable in respect of an "unauthorized act" he must know that the act is dishonest. It is not enough that he should have known it was dishonest.
>
> . . . In the case of deceit and falsehood, the perpetrator who uses these means must know the falsity of his statement or be reckless as to its truth for there to be deceit or falsehood within the meaning of the section. Similarly, in the case of an act, the actor must know that the act is dishonest. Indeed, the very term "other fraudulent means" implies that there must be a fraudulent intent, for without it there can be no fraud.

In *R.* v. *Bobbie* (1988), 43 C.C.C. (3d) 187 (Ont. C.A.), leave to appeal to the S.C.C. denied, the accused, a senior officer of a trust company, was charged with defrauding a trust company by advancing money to investors in excess of the amount authorized, without the approval of the trust company's committee. The accused's defence was that he acted throughout in what he believed to be the best interests of the trust company, and that at the time he made the advances, he believed his dealings would eventually be ratified by the company. He acknowledged that he had made errors in judgment but denied any dishonest intent. The trial judge directed the jury that they had to judge the accused's conduct objectively. On appeal, Brooke, J.A. citing *R.* v. *Doren* and *R.* v. *Currie and Bruce*, *supra*, rejected the trial judge's charge at 190-191:

> . . . He ought to have instructed them that proof of dishonesty requires not only proof that the acts be judged objectively dishonest but also proof that the appellant knew the act was dishonest and intended to act dishonestly. They were never told, as they ought to have been, that their determination of whether the appellant's conduct was dishonest required that they determine what he knew, what he believed and a finding as to his state of mind. . . .
>
> We agree with the appellant's submissions that it was misdirection for the trial judge to instruct the jury as he did regarding the relevance of the evidence as to the appellant's belief he was acting in the best interests of his company, that the board would ratify his actions, the absence of any personal gain, and the evidence with respect to the history of the company in making advances in the absence of authority. This evidence was relevant in determining whether or not the accused acted dishonestly.
>
> Nowhere was the jury told that if they believed the appellant's evidence as to his belief and intention or had a reasonable doubt in that regard, they must acquit him. This was non-direction amounting to misdirection. Further, it was open to the jury on the charge that to knowingly break the company's rules with respect to the advances if loss resulted would amount to fraud. This was wrong. It could be fraud only if the acts were accompanied by the state of mind required to constitute the offence.

Finally, the Alberta Court of Appeal in *R.* v. *Greenberg*, unreported, June 2, 1989, Appeal #70589, adopted the subjective approach to *mens rea*. McClung, J.A. delivering judgment for the court stated at 1-2:

> . . . It was proven that the accused did, and intended, certain acts. But proof of censurable intent escorting those acts failed. [Counsel for the prosecution] says that the mental element for fraud was established upon proof of the intended acts alone and that any additional inquiry into the culpability of the accused's purpose was irrelevant. We have to disagree. The point, fundamental to the traditions of our criminal jurisprudence, has been addressed and decided adversely to the Crown by the considered appellate judgments in *R.* v. *Sebe* . . . and *R.* v. *Bobbie*. . . . In the latter case, leave to appeal to the Supreme Court of Canada was refused. . . .

In dismissing the appeal, the court adopt the trial judge's reasons. The trial judge, adopting *R.* v. *Sebe*, acquitted the accused on the grounds that the crown prosecutor had failed to establish that accused had the dishonest state of mind that was required to sustain a conviction for fraud.

APPENDIX 2

FRAUD AFFECTING PUBLIC MARKETS AND MARKET MANIPULATION

1. INTRODUCTION

The law of civil fraud discussed in Appendix 1 applies to cases involving fraudulent manipulation of public markets. In criminal law, fraudulent manipulation of public markets is the subject of two specific *Criminal Code* provisions: ss. 380(2) and 382.

Civil cases under this heading apply the law of the tort of deceit, and the law of misrepresentation in contract to fraudulent conduct of a type. As in other cases with different fact patterns, here too the tort of deceit is no longer a common basis of liability in the cases because negligent misrepresentation is now actionable. The same damages flow (except for the possibility of exemplary damages for deceit) but proof of negligence is easier than proof of intentional misrepresentation. The civil cases will be outlined below, followed by an outline of the criminal law in this context. First though, a brief outline of certain key concepts concerning public markets.

The term "market value" was defined in *North American Teleg. Co.* v. *Northern P. R. Co.*, 254 F. 417 (8th Cir. 1918), *cert. denied*, 249 U.S. 607 (1919), as the price established in a market where the article is dealt in by such a multitude of persons and in such a large number of transactions as to standardize the price. Along the same lines in *Pett* v. *Spiegel*, (1923) 202 N.Y.S. 650 (1923), 4 Am. Bankr. Rep. (N.S.) 207 the market value of a stock was said to be established like the market value of any property when it has been the subject of purchase and sale to so great an extent and in so many instances that its value has become fixed.

Berle, "Liability for Stock Market Manipulation" (1931), Columbia Law Review 264 writes at 267 that "In theory a stock exchange is strictly a 'market'; that is, a place where buyers and sellers through certain established representatives or brokers freely meet and freely contract. Through the operation of such a 'market', it is assumed that there will be so many buyers and so many sellers, effecting so many transactions, that the price of property of like quality and kind becomes fixed or standardized, as it cannot be where there is a single sale or a single party." According to Berle the economic function of a stock market is ". . . to provide a free place of exchange wherein at all times investors may place their funds, and may at all times withdraw them, thereby attaining liquidity for probably otherwise non-liquid investments of capital."

Moore and Wiseman, "Market Manipulation and the Exchange Act" (1934), 2 U. of Chi. L. Rev. 46 write at 48 that "Before market quotations can be accepted as an accurate appraisal of a security, the market must be free and open, both in the sense of liquidity — the continuous operations of buyers and sellers, and in the sense that price is honestly chancered. To effect the latter, buyers and sellers must have adequate financial information and the opportunity to trade on an unrigged market."

What is meant by manipulation? Moore and Wiseman write at 50 that "The term 'manipulation' may, in short, be applied to any practice which has as its purpose the deliberate raising, lowering or pegging of security prices. Buying and selling in themselves do, of course, affect price, but in a free and open market this is a natural consequence and not their pre-conceived purpose. Manipulation leads to an artificial and controlled price. Such a price, which is broadcast in the form of a market quotation, then, does not reflect an independent appraisal of the security in respect to the floating supply, nor to the immobile holdings throughout the country."

Cases have addressed the degree to which market interference will be tolerated. One form of interference has come to be known as "rigging the market". The term "rigging the market" has been defined as ". . . inflation of the price of securities on the market by fraudulent means": Schwabe and Branson, *A Treatise on the Laws of the Stock Exchange* (1913, 2nd ed.) at 260. Not all deliberate inflation of market prices is fraudulent. Nor are all pooling arrangements. These methods of affecting market prices are considered within the legal framework outlined below. Other schemes common to these cases include setting up a "box", and "wash trading". Of course many are cases of more direct misrepresentation.

Stock exchange administrators and provincial Securities Commissions have some regulatory power to respond to manipulative or deceptive trading. Generally speaking, their jurisdiction is limited: in the case of exchanges, to their members and affiliates; in the case of Securities Commissions, to ordering that trading cease in respect of a security. *See: The Alberta Stock Exchange Act*, S.A. 1974-75, c. 79; *The Alberta Stock Exchange By-Law*, especially s. 21.14 "Powers and Remedies"; *Securities Act*, R.S.A. 1980, c. S-61, ss. 165 and 166. Resort is had to civil and criminal law to respond to fraudulent or manipulative trading in any way beyond the exercise of those modest powers.

2. CIVIL LAW

In *Scott* v. *Brown, Doering, McNab & Co.*; *Slaughter & May* v. *Brown, Doering, McNab & Co.*, [1892] 2 Q.B. 724 (C.A.) the plaintiff Brown sued to recover money paid to the defendant McNab, a member of the London Stock Exchange, for the purpose ". . . that McNab should therewith purchase 500 shares of [a] projected company, when brought out, at a premium (at the time of the agreement there was neither company nor market), the sole object of such purchase being that the public might thereby be induced to believe that there was a real market for the shares, and that they were at a real premium, whereas in truth and in fact, as the plaintiff and the defendant McNab well knew, they were not" *per* Smith, L.J. at 732-733.

The basis of the claims made by the plaintiffs was that the defendant brokers delivered to the plaintiffs their own previously purchased shares rather than shares purchased for the plaintiffs in the ordinary way.

It was held that whatever else may be the case, no court would enforce the contract because it was illegal. In dismissing the case the court emphasized that the action was barred on principle; Smith, L.J. said at 734: "If a plaintiff cannot maintain his cause of action without showing, as part of such cause of action, that he has been guilty of illegality, then the Courts will not assist him in his cause of action."

The illegality was revealed in the court's characterization of the contract as being ". . . a deceitful and fraudulent means whereby to cheat and defraud those who might buy shares in the company" because the project was for ". . . the sole purpose of creating . . . a fictitious premium, in order to induce the public to purchase shares in the company. . ." *ibid*. The plaintiff and McNab were jointly interested in bringing out the company and floating its shares upon the market.

In his exposition and application of the law Smith, L.J. expressed the opinion that the plaintiff's conduct was criminal as well as actionable in civil law: *see* Appendix 4. At 734 Smith, L.J. said:

> Test it in this way. Suppose a purchaser induced to purchase shares of the plaintiff or McNab by means of the fictitious premium created by them solely for the purpose of inducing such purchaser and others to buy, could he or not have successfully sued either or both for a false and fraudulent misrepresentation? I say that he could, and this is another way of stating the same proposition — viz., that the plaintiff and McNab agreed by means of deceit and fraud to cheat and defraud the would-be purchasers of shares. The agreement to do an illegal act by illegal means is proved, and for the reasons above both the plaintiff and McNab were liable to be indicted for conspiring to cheat and defraud.

Lindley and Lopes, LL.J. wrote concurring judgments. Lindley, L.J. said at 729 that although the plaintiff's purchase of shares was not a sham, the contract was fatally tainted because ". . . the sole object of the purchase was to cheat and mislead the public". That the conduct may have been common was no defence. The learned judge said *ibid* that, "Picking pockets and various forms of cheating are common enough, and are nevertheless illegal".

Schwabe and Branson, *supra* state at 263 that rigging such as that found in *Scott* v. *Brown, et al*, *supra*, must be distinguished from "... the legitimate making of a market, that is, the intentional enhancement of the price of some security, or the causing of a demand for it, without any fraud or false representations." They write at 263-264:

> There is nothing illegal, for instance in pooling shares, and then instructing a member, whether broker or jobber, to offer them at not less than a certain price, and to buy all that are offered at that price. Nor is there anything wrong in such member having the shares quoted on the tape at the price at which he is willing to deal, [provided it was not obtained for the purpose of inducing persons to believe that there had been dealings, when in fact there had not], nor in agreeing with such member to take off his hands all or any part of such shares as may be bought by him in order to support the market. A person may sell his property in a market at any price he likes, provided he does not use fraudulent means to dispose of it.

The terms "jobber" and "broker", as used in this context are explained in the report of *Merry* v. *Nickalls* (1869), Law Rep. VII Ch. 733 at 735 as follows:

> According to the rules and usage of the *Stock Exchange* its members deal with one another as principals; whether they act as brokers or not, and persons outside who employ members as brokers are not recognized as parties to any transactions between members. For the convenience of business, there has grown up a distinction between brokers and jobbers. The business of a jobber is to bring together buyers and sellers, or, in other words, to make a ready market. When a broker is instructed by his principal to sell shares on the *Exchange*, he applies to a jobber to make a price for the class of shares in question, without saying whether he desires to sell or buy, and the jobber thereupon names two prices; the lower being his price to buy, and the higher his price to sell . . . .

A free market contemplates appraisal of the value of the stock by both buyer and seller: Berle, *supra*, at 268. The following two cases from Massachusetts at the turn of the century are examples of that principle being undermined. In *Kilgore* v. *Bruce*, 166 Mass. 136, 44 N.E. 108 (1896), a seller of stock advised his buyer that he was selling an entire block of stock to a number of people all of whom were paying $1,900 per share. In fact the other parties were paying only part consideration. The court held that the buyer should be credited with the damage occasioned by the false representation, drawing heavily on the analogy of a by-bidder or fictitious bidder at an auction sale. It was stated that representations as to what others were paying were plainly material and plainly important.

In the second example, *Stewart* v. *Joyce*, 201 Mass. 301, 87 N.E. 613 (1909), the plaintiff was induced to sell stock on the representation that the defendant was buying not for any outsiders, but for himself; and that he had bought the stock at not more than 80¢ per share. In fact, the defendant was buying for the controlling interest in the company. It was held that the representation of the price obtained in a free market was material. The plaintiff was accordingly allowed to rescind the contract.

Berle, *supra*, notes at 268 that "... it seems to be an established rule of law that any statement of any kind issued by anyone and intended to affect the price of, or to be used in appraising a security must be accurate; and that the knowing publisher of false information is liable in an action for fraud to anyone who relies on it, or, probably, even to anyone who acts to his loss in the open market on a false valuation as a result of such statement."

As with the law of civil fraud generally, to be actionable it is not necessary that the false statement be made directly to the purchaser. In *Bedford* v. *Bagshaw* (1859), 4 H. & N. 538, 157 Eng. Rep. 951 (Exch.) false representations were not made to the plaintiff, but rather, were made to the London Stock Exchange Committee who in reliance upon those statements listed the defendants' shares on the Exchange. In an action for deceit, a verdict for the plaintiff was sustained. Berle, *supra*, notes at 269:

> . . . The chain of causation between the statement relied upon and the price adopted by the investor is slightly longer than in the ordinary case of deceit, but is no less direct. If

> the X corporation states that its earnings are $13 a share when, in fact, its income statement should really show a loss, and the market estimates the value of the stock at $130 on the basis of such statement, and the investor buys at the market price, he has relied on the market situation, which in turn resulted from the false statement.

New York, Miller v. *Barber*, 66 N.Y. 558 (1876) provides another example of facts within this category. The court held that there had been a material misrepresentation where the seller of stock represented that large blocks of stock had been sold to substantial buyers. Such sales had in fact been made but they were made for notes, and there was a private agreement that the notes should never be enforced. The court held that the misrepresentation was material as indicating that the buyers were prepared to pay and had paid for the stock at the price represented, whereas in fact they were not so prepared, and had not paid the price.

Berle, *supra*, writes at 270 that ". . . the highest type of representation that can be made to the market is the representation contained in the published report of a sale." He further states that it is "an almost universal rule of the exchanges that all transactions, at least those involving a variation in price, shall be promptly reported, and in fact, they become open market information within a very few seconds. This constitutes an open representation to the market of an appraisal at which one party has been willing to sell and another party willing to buy; and it promptly becomes an element in every subsequent appraisal, at least for a period of time."

Fraudulent manipulation must be distinguished from rendering acceptable assistance to the market in ascertaining what is believed to be an appropriate value for shares. In certain situations it may be "necessary or appropriate in the public interest or for the protection of investors" to stabilize the price of shares: *see Securities & E. Commission* v. *Otis & Co.*, 18 F. Supp. 100 (D.C. 1936).

An example of permissible interference is the pooling arrangement impugned in *Sanderson & Levi* v. *British Westralian Mines & Share Corp.* (1898), 43 Sol. Jo. 45 (Q.B.) (affirmed, London Times July 19, 1899 (C.A.), also reprinted in *United States* v. *Brown*, *infra* at 90). Matthew, J. delivering judgment for the court stated that:

> . . . It was to the interest of the defendants that the public should be induced to deal in [certain shares], and with that object an ordinary pooling arrangement was decided upon and the plaintiffs and Luning were authorized to carry it through. No evidence had been given to shew that the arrangement differed from what was done every day on the Stock Exchange, or that there was anything of an illegal or fraudulent character about it. A "pooling" agreement *per se* was not illegal as being opposed to public policy, nor could it be said, in the absence of fraud, to be a contract *ultra vires* of a board of directors.

Smith, L.J. (with whom Romer, L.J. agreed) affirming the decision of Matthew, J., stated (as reprinted in *U.S.* v. *Brown*, *infra*, at 91):

> Where is the fraudulent conspiracy to cheat and defraud between the defendants and the plaintiffs now set up by the defendants, or where is proof of anything done against public policy, or where is there any sham in the case.
>
> In the first place I apprehend that a person may sell his property in a market at what price he likes, supposing he does not use fraudulent means to induce others to purchase. If the defendants had employed a broker instead of a jobber to do what the plaintiffs did, that is, to buy from sellers and sell to purchasers, can it be said that anything illegal would have taken place, for may not a man buy up in a market wares which otherwise might compete with his own at a price which he thinks expedient? Surely he may. But it is said that the employment of a jobber and not of a broker to effect this makes all the difference and constitutes the transaction fraudulent and illegal. It is said that upon the Stock Exchange a jobber when asked to make a price, if he does so, is bound either to buy or to sell at the price named as the customer desires, and in this I agree. But how does the fact of one

> jobber naming his price so stereotype the market of the shares that no other jobber can name another price? Again, how does the fact that the jobber has another person engaged with him (Luning in this case), or has taken an indemnity, show that the jobber is cheating and defrauding the public when he gives the price at which he is willing to either buy or sell? It does nothing of the kind, and I do not believe that a single person purchasing shares upon the Stock Exchange thinks for a moment about the private arrangements of the jobber, or how he makes his profit, or whether he is indemnified or not. This is my belief; but, if it be erroneous, where is the evidence to support the assertion that, if the jobber is assisted by another or is indemnified, it is fraudulent or illegal to make the price he does? On the contrary, the evidence is all one way, and shows that what took place between the plaintiffs and the defendants was absolutely ordinary. Uncontradicted evidence was also given that upon the Stock Exchange particular firms of jobbers deal in the Westralian market, which is called "a shop" for the shares, which indicates that there is no need for the intervention of a broker. In my judgment, what a jobber does in making a price is simply that he gives out that at the price he makes he is willing either to buy or to sell, and in the present case in making a price the plaintiffs told the simple truth, for at the prices they made they were in truth and in fact willing either to buy or to sell, and there is, as my brother Matthew says, nothing fictitious about the case and much less fraud.
>
> Passing the price named through the tape in my opinion is nothing more than that at that price there is a jobber willing to deal either as buyer or seller, and so in the present case there was.

The foregoing tort cases are illustrations of the application of the law of deceit. In every case where the plaintiff succeeds the four essential elements of the tort are established, according to the law as expressed in *Bradford Third Equitable Benefit Building Society* v. *Borders*, [1941] 2 All E.R. 205 (H.L.) *per* Viscount Maugham at 211. Those essential elements are reviewed in some detail in Appendix 4. Expressed concisely, the elements are: first, a representation of fact, which in these cases is frequently articulated by stock quotes in the public domain; secondly, knowledge on the part of the representor that the representation is false; thirdly, the representor must intend that the representation be acted upon; fourthly, the plaintiff must have acted upon the representation and sustained damage.

The contract cases considered above also apply general principles of civil liability for fraud; the legal framework in which those principles operate is outlined in Appendix 1 under the heading "Civil Fraud". The cases illustrate the principle that, "where a person has been induced to enter into a contract as a result of a fraudulent misrepresentation by the other contracting party, he may rescind the contract, or claim damages, or both": *Chitty on Contracts* (1983, 25th ed.) at para. 410.

The cases assess fraud against the standard expressed by *Chitty* as follows at para. 411:

> The common law relating to fraud was established by the House of Lords in *Derry* v. *Peek* (1889), 14 App. Cas. 337. It was there decided that in order for fraud to be established, it is necessary to prove the absence of an honest belief in the truth of that which has been stated; in the words of Lord Herschell, "fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false." The converse of this is that however negligent a person may be, he cannot be liable for fraud, provided that his belief is honest; mere carelessness is not sufficient, although gross carelessness may justify an inference that he was not honest.

3. CRIMINAL LAW

The earliest common law judicial recognition of the public interest in a free and open securities market was in English cases concerning circulating false rumours to raise the price of public funds and securities: e.g., *Rex* v. *De Berenger* (1814), 3 M. & S. 67, 105 Eng. Rep. 536 (K.B.). That case recognized that the raising or lowering of the price of public funds was not a crime *per se* because one may have occasion to sell out a large sum, which may in turn have the effect of depressing the price of stocks, or alternatively may buy in a large sum and thereby raise the price of stocks on a particular day and yet not be guilty of an offence. However, Le Blanc, J. stated at 539 that ". . . if a number of persons conspire by false rumours to raise the funds on a particular day, that is an offence; and the offence is not in raising the funds simply, but in conspiring by false rumours to raise them on that particular day." The object was wrong: to put a false value on a security, without foundation, to the necessary prejudice of market participants. *See also*: *R.* v. *Aspinall* (1876), 2 Q.B.D. 48 (C.A.).

The common law cases discussing market manipulation were extensively reviewed in *United States* v. *Brown*, 5 F. Supp. 81 (S.D.N.Y. 1933), aff'd. 79 F.2d 321 (C.C.A. 1935), *cert. denied* 565 S.Ct. 309 (1935). In that case, the accused were charged and convicted of using the mails in connection with a scheme to defraud by forming a pool to artificially manipulate the stock of Manhattan Electric Supply Company Inc. without regard to its real value and of conspiring to that effect. With respect to whether the indictment set forth a crime, namely, a scheme or pool to raise the price of a security listed on an exchange, Woolsey, J. stated at 85:

> The theory pressed on me for the defendant McCarthy, as I understand it, is substantially this: That, if two or more persons, through the operation of what is known as a "pool", agree to raise the price of a security on a stock exchange, they may proceed to achieve that objective without being guilty of any actionable fraud, vis-a-vis a member of the public who purchases that security relying on the exchange market quotations, on the theory that the maxim of caveat emptor applies. But that maxim applies properly only to free and open markets.
>
> When an outsider, a member of the public, reads the price quotations of a stock listed on an exchange, he is justified in supposing that the quoted price is an appraisal of the value of that stock due to a series of actual sales between various persons dealing at arm's length in a free and open market on the exchange, and so represents a true chancering of the market value of that stock thereon under the process of attrition due to supply operating against demand. Cf. *North American Telegraph Company* v. *Northern Pacific Company* (C.C.A.) 254 F. 417, 418.
>
> If, however, the market for the stock listed on an exchange is a manipulated or controlled market, in which a group of insiders, in order to enable themselves profitably to dispose of their holdings, are artificially raising the quoted price of the stock on the only market to which any man who wishes to purchase that stock would inevitably resort, and an outsider buys in that market he obviously pays more — how much more perhaps cannot be estimated and, in any event, in a criminal case of this kind, is not material — than he would have paid in a free and open market, and hence is a victim of unfair dealing by the insiders. But he is entitled to fair dealing and should get it. *Wilson* v. *United States*, 190 F. 427, 433, 434 (C.C.A. 2); *Looker* v. *United States*, 240 F. 932, 933-935 (C.C.A. 2).
>
> The test of such fair dealing is the test to be applied in determining whether the scheme set forth in this indictment is fraudulent or not.
>
> If it is contended, as I understand it is contended, that a man who buys a stock in hope of a rise and a chance to sell at an advance is speculating, my answer is that this matters not. For even a speculator is entitled not to have any present fact involving the subject-matter of his speculative purchase or the price thereof misrepresented by word or act.
>
> As a result, a purchaser of a stock whose price is artificially raised by a pool is unfairly dealt with, for he has to pay more than he should pay for the stock, whether he be an investor or speculator.

Following consideration of two civil cases, *Scott* v. *Brown* and *Sanderson & Levi*, *supra*, Woolsey, J. went on to state at 93:

> It seems to me that the teaching of these cases is that, where two or more persons engage in a so-called pool operation on a stock exchange in respect of a stock, it is only by scrupulously maintained honesty of dealing, such as the court found to be the fact in the *Sanderson and Levi* case, that they may escape condemnation as a fraudulent conspiracy. The slightest step over the line of absolute fair dealing takes them into a zone of condemnation by the courts, and the doctrine applicable to each member of the pool is the new maxim — caveat venditor.
>
> It is obvious that, when two or more persons, by a joint effort, raise the price of a listed stock artificially, they are creating a kind of price mirage which may lure an outsider into the market to his damage.
>
> In my opinion, such a procedure would of itself constitute a fraud on the public — just as was held in *Scott* v. *Brown*, [*supra*]. A fortiori, when such a procedure is accompanied by active propaganda seeking to interest the public in the shares thus artificially raised in price, it becomes the grossest kind of fraud. That is what I find set forth in the indictment before me.

On appeal, Hand, J. while affirming the conviction, declined to enter into a general discussion of the lawfulness of stock "pools", as Woolsey, J. did in the court below, saying that the indictment contained enough else and that he would leave the matter open.

In modern Canada the *Criminal Code* has particular provisions concerning fraud as it affects the public market price of shares. Section 380(2) deals with price manipulation of commodities offered for sale to the public and provides as follows:

> 380(2) Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretense within the meaning of this Act, with intent to defraud, affects the public market price of stocks, shares, merchandise or anything that is offered for sale to the public, is guilty of an indictable offence and is liable to imprisonment for a term not exceeding ten years.

The accused in *R.* v. *McNaughton* (1976), 43 C.C.C. (2d) 293 (Que. C.A.) was convicted at trial on a charge of conspiring with others to commit an indictable offence, "to wit: by deceit, falsehood or other fraudulent means . . ., with intent to defraud, affect the public market price of shares of Pan American Mines Ltd., the said shares being offered to the public . . .". His appeal was dismissed on the ground that he was party to the operation of a "box" that was used to manipulate the stock of Pan American in order to cause the value of its shares on the market to rise.

A box is conceptually intended to effect or assure a well ordered market for newly introduced stock. Schwartz, operator of the box, required, as he received from the promoters, shares of the company, and money, which he received from the accused. Turgeon, J. A. explained the workings of the box at 297 as follows:

> When the price of the stock or rather of the security rose in an excessive way because of a large demand, the operator of the box sold on the market through the agency of the Exchange a part of the shares which he had in his possession. On the other hand, when the proportion of shares declined in an undue fashion as a result of too large a number of shares being offered for sale, the operator of the box bought these shares at the Exchange with a view to stabilizing the market.

Two companies were used in the operation of this box. Their roles were explained at 299 as follows:

> The role of American Investment Corporation was to sell shares of Pan American Mines that the promoters had placed with Guaranty Trust Company and in proportion that the shares were released. On the other hand, the role of Miramar was to buy shares at the exchange through the agency of the brokerage firm of Holland, Anders and Perrier.

American Investments belonged to the accused, who was its principal shareholder. Miramar belonged to Schwartz, who was a convicted co-conspirator. Using these two companies created the impression of arm's length transactions. That impression was reinforced by both companies making the transactions through a brokerage firm which was bound to report the transactions to the exchange. "It was preferred to act in this way and to pay large commissions to the broker, without doubt so that [a given] transaction was known to the public in order to maintain the illusion that the market for the shares of Pan American was very active" *per* Turgeon, J. A. at 299.

Also pertinent to the scheme and to the conviction of the accused was the fact that, "From June to December, 1971, American Investment Corporation sold to the public, through the agency of the Canadian Stock Exchange, 482,058 shares. On the other hand, during the same period, Miramar Investments bought from it 287,450" *per* Turgeon, J.A. *ibid*. The learned appeal judge continued at 299-300 as follows:

> . . . In the present case, the box stood as purchaser of shares on the market when it had enormous quantities of them in reserve. It often happened that the box made the last acquisitions of the day and at a higher price than that of the next to the last transaction. The purpose was to show in the financial pages that the shares at the closing were on the rise. In many cases, Miramar bought the shares when the market was already on the rise. On the other hand, American Investment sold the shares when there was a great quantity of shares available on the market and there was no threat of fluctuation on the rise.
>
> It appears from the [evidence] . . . that the box has been an instrument of manipulation. The shares of Pan American Investment, which were listed at $1.50 each when they were put on the market reached $12.00 at the end of August, 1971, to later be selling in the middle of November, 1971, between $1.20 and $2.10 per share. Thanks to the operations of the box, the promoters realized profits in the order of $750,000 in the space of a few months for the activities of the box only lasted from June to November, 1971. These profits, realized at the expense of the public, were in a large part remitted to the American promoters.

In separate, concurring reasons, Montgomery, J.A. noted as follows at 294:

> . . . The trial Judge did not have to decide whether a box was necessarily an illegitimate device; he was concerned solely with the operation of this particular box. This operation was conducted, not to stabilize the price of the stock, but to drive it up to a level completely disproportionate to its intrinsic value, a level that could not possibly be maintained. This was clearly of great financial benefit to those closely connected with the operation of Pan American Mines, or at least some of them, but detrimental to the investing public. The trial Judge found that this enhancement of the market price was effected by fraudulent means, and I see no reason to doubt the correctness of his finding.

The accused in *R.* v. *Alston*, [1980] 5 W.W.R. 560 (Alta. Q.B.) were charged with conspiring to commit and committing the indictable offence of affecting the public market price of shares in the capital stock of Savanna Resources Ltd. The accused Alston, was the chief executive officer of Savanna and Perry River Nickel Ltd. The accused Zuidinga, was the manager of an investment company, Wirtschaftsticker A.G., which was indebted to Perry River and Savanna. The Alberta Securities Commission gave Wirtschaftsticker permission to sell shares it held in Savanna so the money could be applied to the debt owing to Perry River. The shares were transferred to a Perry River account in Vancouver. It became apparent at about the same time that Perry River shares were volatile. Alston opened an account in Calgary for the purposes of stabilizing the price of Perry River shares. He was to operate it on behalf of Wirtschaftsticker.

In March, 1978, Alston decided to increase the rate at which he was selling Savanna shares since Perry River required the cash. Zuidinga wished to acquire them for his German clients as he felt the company had good prospects. And so, purchase orders of German clients were placed by Alston through the Calgary account and shortly thereafter Alston placed sell orders through the Vancouver account. While the scheme gave the appearance of public interest being created in the shares of Savanna to other investors, both Alston and Zuidinga denied this intention and claimed that their purpose was to distribute the shares in an orderly manner with the least possible fluctuation in the market price. In dismissing the charges, Medhurst, J. stated at 572:

> . . . In the final determination however, in order for the accused to be convicted, it is essential for the Crown to prove beyond a reasonable doubt that the accused did the acts complained of with guilty intent. That is an onus which never shifts. It is not incumbent on the accused to show that they did the acts with some intent other than that with which they have been charged.
>
> . . . While the method employed may or may not have been that which was authorized [by the order of the ASC] it is nevertheless arguable that it was. The means by which the shares were sold undoubtedly affected the market price of Savanna shares because of the appearance of great interest as a result of buy and sell orders placed by Alston. Nevertheless, the explanation given by the accused is one that is capable of belief and accordingly the necessary fraudulent intent has not been proven beyond a reasonable doubt.

In *R.* v. *Allman*, unreported, [1984] B.C.D. Crim. Conv. 5505-01, the British Columbia Court of Appeal upheld the conviction of the accused on a charge of conspiring to affect the market price of shares of Grand Prix Resources Ltd. (listed on the Vancouver Stock Exchange) with intent to defraud, and of having unlawfully matched purchase and sale orders for Grand Prix shares with the requisite intent of creating a false or misleading appearance with respect to the market price of those shares. In dismissing the appeal, Seaton, J.A. stated at 9:

> Several grounds of appeal turned on the allegation that these people honestly believed that the market price to which the shares were driven was a fair and legitimate price. It is said that if that is the case there is no *mens rea*. It is also said that there was no *actus reus* if there was no deprivation. I do not think these contentions to be sound. By deceit, the appellant and Kohn affected the market price of shares. Their intention was to cause people to part with their money in exchange for shares or not acquire money by disposing of their shares. In short, they were deceiving people into having shares instead of money. There was a risk of prejudice to them. It is not necessary for the Crown to prove in addition that there was actual economic loss, or indeed that the accused persons intended that they suffer economic loss. . . .

The learned appeal judge, following the decision in *R.* v. *Olan*, [1978] 2 S.C.R. 1175, reviewed in detail in Appendix 1, went on to state at 10-11:

> The trial judge found that Allman and Kohn, . . . conspired and offered to pay secret commissions as part of a scheme to control the market price for shares. . . . [T]hey used accounts in the names of others to mislead the public. . . . [O]rders for the sale of Grand Prix shares were based on information obtained respecting purchase orders and the actions were to the detriment of the public. . . . [T]hey conspired to and did pay secret commissions or bribes to persons in the securities industry for the purpose of inducing those persons to cause members of the public to buy Grand Prix shares. To all of this, the answer that there was no deprivation, no intention to defraud, that everything that they were doing was in the best interests of the public, I find quite unrealistic.
>
> An argument that is common to a number of grounds is that the words in the indictment, "with intent to defraud of money or other valuable securities", focuses the Crown's onus. It is my impression that the allegation was made out if what I just said is accepted; that is, that a person is defrauded of money if he is induced dishonestly to buy shares, regardless of the values of those shares. That seems to me was the intention, and in a conspiracy count it is the intention that is vital.

The second provision of the *Criminal Code* which concerns fraud affecting public markets, in addition to s. 380(2) is s. 382. It provides as follows:

> 382. Every one who, through the facility of a stock exchange, curb market or other market, with intent to create a false or misleading appearance of active public trading in a security or with intent to create a false or misleading appearance with respect to the market price of a security,
>
> (a) effects a transaction in the security that involves no change in the beneficial ownership thereof,
>
> (b) enters an order for the purchase of the security, knowing that an order of substantially the same size at substantially the same time and substantially the same price for the sale of the security has been or will be entered by or for the same or different persons, or
>
> (c) enters an order for the sale of the security, knowing that an order of substantially the same size at substantially the same time and at substantially the same price for the purchase of the security has been or will be entered by or for the same or different persons,
>
> is guilty of an indictable offence and is liable to imprisonment for five years.

Whereas s. 380(2) requires an "intent to defraud", s. 382 requires either an "intent to create a false or misleading appearance of active public trading in a security" or an "intent to create a false or misleading appearance with respect to the market of a security."

So-called "wash trading" is one type of mischief within the purview of s. 382. Intention to mislead is an essential element of the offence, as demonstrated by the decision in *R.* v. *Jay*, [1965] 2 O.R. 471 (C.A.). The accused was convicted at trial of entering purchase orders for a security and, at substantially the same time, entering sale orders for that security at substantially the same size and price. On appeal the court held that the types of transactions detailed in s. 382(b) are not illegal unless there is the accompanying intent to create a false or misleading appearance of active public trading in a security or to create a false or misleading appearance with respect to the market price of a security. The court stated at 473:

> It is clear from the plain wording of s. 325(b) [now s. 382(b)] that Parliament did not make the entering of purchase and sale orders corresponding substantially as to time, quantity and price *per se* a crime. It is a crime only if they are so entered with the intent specified in the enactment. That specified intent is an essential ingredient of the offence: without it there is no offence. From the foregoing it follows that Parliament must have recognized that such corresponding purchase and sale orders could be entered without the specified intent. It may be difficult to prove that intent but the difficulty does not dispense with the necessity of so doing.

The conviction was quashed on the basis that it was the accused's purpose, in initiating the trans actions, to purchase enough of the shares to secure his election to the Board of Directors of the company, and that intended purpose was supported by the evidence. Roach, J. A. indicated that someone with an interest in purchasing the shares would want to avoid dramatic changes in the price of shares and stated at 474:

> A purchaser intending to accumulate a portfolio of shares in a given company at the most advantageous price would be interested in preventing a continuing rise or skyrocketing in the market caused by his own continuing buying and as a brake against that possible result, would be justified in his own interest in putting some of his own shares on the market in an effort to have the supply offset the demand. In other words, he would try to stabilize the price for his own advantage and if that alone was his purpose, then he would not have the intent which is an element of the offence created by s. [382(b)]. To put it otherwise, he would not thereby intend to create a false appearance of active public trading. His purpose would be legitimate. There is no evidence in this case to negative that legitimate purpose.

R. v. *MacMillan* (1968), 66 D.L.R. (2d) 680 (Ont. C.A.) was also a "wash trading" case where the accused was convicted at trial. One ground of appeal was that there was no or insufficient proof that the appellant intended to create a false or misleading appearance of active public trading in the shares or intended to create a false or misleading appearance with respect to the market price. At trial, the accused did not testify or call any witnesses to explain why she was involved in the stock transactions. McLennan, J.A., delivering judgment for the court, stated at 686-687 concerning this ground of appeal:

> . . . It is beyond dispute that the cross-trade created a false or misleading appearance of active public trading. The appellant was a knowledgeable person with respect to trading in securities; she was interested financially in different ways in the shares of Golden Arrow and she must be taken, in the absence of evidence from which some other reasonable explanation might be inferred, not only to have foreseen the probable result of the large cross-trade but to have as her real and dominant intention in carrying out the transactions the probable result so foreseen.
>
> . . . [T]he purpose of the section is to prevent fraudulent misuse of the facilities of a stock exchange for profit. I use the term "fraudulent" advisedly because effecting the kind of transactions described in paras. (a), (b) and (c) with either intent mentioned therein is a fraudulent misrepresentation by conduct made to members of the public trading on the Exchange.

In *Lampard* v. *The Queen*, [1969] S.C.R. 373, the accused was charged with being involved in "wash trades" and the only issue was whether or not the accused had the requisite intent to create a false or misleading appearance with respect to the price of securities. In reviewing judgment of the Court of Appeal, Cartwright, C.J.C. quoted from that court's reasons as follows at 378:

> It is, I think, irrefutable that a false and misleading impression of active public trading was created with respect to that count and so with all the other counts. The ticker tape records of the transactions impeached with respect to the total volume each day carried to a greater or lesser degree, depending upon the relationship between the wash trades and the total volume of shares traded, a false and misleading appearance of active public trading in the shares.
>
> The respondent did not give evidence himself nor did he call any witnesses on his own behalf. He had been in the brokerage business for many years and must be taken in the absence of evidence from which some other reasonable explanation may be inferred, not only to have foreseen that each wash trade would create a false appearance of active public trading, but to have intended that result. . . .

Cartwright, C.J.C. continued as follows at 379-380:

> The basis of the decision of the Court of Appeal is found in the sentence . . .
>
> > . . . Here the facts are not in dispute and as I have said the only inference which can be drawn from the facts in the record is that the respondent intended to create a false and misleading appearance of active public trading which raises a question of law and the Crown has a right of appeal.
>
> With the greatest respect I am unable to agree that a question of law was raised. It is not correct to say that the facts are not in dispute. There is dispute as to the vital question of fact whether the appellant did the acts which he is proved to have done with the guilty intention specified in the section.
>
> To determine whether an act, admittedly done, was done with a certain intention it is necessary to inquire into the state of mind of the doer. That such an inquiry is as to a matter of fact has often been held.

The learned chief justice elaborated at 380-381:

> Unless the doer of the act has expressed his intention, the finding as to what that intention was will necessarily be founded on an inference drawn from all the relevant circumstances proved in evidence. . . .
>
> When the onus of establishing a certain fact lies upon a party it may be a question of law whether there is any evidence (as distinguished from sufficient evidence) to prove that fact. In the case at bar the onus was, of course, upon the Crown to prove that the appellant did the acts complained of with the guilty intention specified in the section. . . .

The policy basis underlying the market-related provisions, in particular s. 382, was suggested by McLennan, J.A. in *MacMillan*, *supra*, at 687 to be as follows:

> There is a further consideration for the sanctions in [s. 382]. To the extent that the economy of the country is based upon enterprises requiring capital and therefore the free trading in securities it is of the utmost importance that public confidence be maintained in the integrity of trading on the stock exchanges which are in one sense public utilities and also that a similar confidence be maintained in the financial community serving that phase of economic life. Wash-trading inevitably adversely affects such public confidence.

APPENDIX 3

DIRECTORS' DUTIES AND OPPRESSION, UNFAIR PREJUDICE OR UNFAIR DISREGARD OF SECURITY HOLDERS' INTERESTS

1. INTRODUCTION

Section 223(2) of the *Business Corporations Act*, S.A. 1981, c.B-15, as amended ("*BCA*"), the section empowering the court to order this Investigation, provides as follows:

> 223(2) If, on an application under subsection (1), it appears to the Court that there are sufficient grounds to conduct an investigation to determine whether
>
> • • • • •
>
> (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted, or the powers of the directors are or have been exercised, *in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of* a security holder,
>
> • • • • •
>
> the Court may order an investigation to be made of the corporation and any of its affiliated corporations. (Emphasis added.)

The underscored phrase appears also in the orders of July 15 and 29, 1987. Therefore the law pertaining to the assessment of whether any activity or conduct falls within the impugned class of conduct forms a part of the legal framework that guided my Investigation.

Although s. 223(2)(b) of the *BCA* has not been judicially considered in this regard, the three tests — oppression; unfair prejudice; and, unfair disregard — are also employed in ss. 207 and 234 of the *BCA*. The former section concerns the grounds upon which a court may order liquidation and dissolution of a corporation; the latter concerns other orders available in court in cases of oppression or unfairness. Applications invoking these provisions usually are at the suit of shareholders, but there may well be little distinction in some respects between their interests and the interests of security holders within the terms of s. 223.

Each of the key phrases in s. 223(2)(b) of the *BCA* will be considered below separately and in turn. "Business or affairs" is straightforward. The word "affairs" concerns relationships within a corporate structure (see s. 1(a) of the *BCA*) but excludes "business", which concerns the trade or enterprise or undertaking of the corporation.

2. POWERS OF THE DIRECTORS

Pursuant to the *BCA*, s. 1(h.1) "director" means "a person occupying the position of director . . .". A person's consent, either express or tacit, is required or the person is not a director. In this regard ss. 100(5) and (6) of the *BCA* provide as follows:

> 100(5) A person who is elected or appointed a director is not a director unless
>
> (a) he was present at the meeting when he was elected or appointed and did not refuse to act as a director, or
>
> (b) if he was not present at the meeting when he was elected or appointed,

> (i) he consented to act as a director in writing before his election or appointment or within 10 days after it, or
>
> (ii) he has acted as a director pursuant to the election or appointment.
>
> (6) For the purpose of subsection (5), a person who is elected or appointed as a director and refuses under subsection (5)(a) or fails to consent or act under subsection (5)(b) shall be deemed not to have been elected or appointed as a director.

Section 97(1) of the *BCA* provides as follows:

> 97(1) Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation.

The *BCA* contemplates that the power of the directors to manage the business and affairs of the corporation may be restricted by a unanimous shareholder agreement: s. 140(1)(c). The Act provides in ss. 140(7) and 1(z) as follows:

> 140(7) A shareholder who is a party or is deemed to be a party to a unanimous share holder agreement has all the rights, powers and duties and incurs all the liabilities of a director of the corporation to which the agreement relates to the extent that the agreement restricts the powers of the directors to manage the business and affairs of the corporation, and the directors are thereby relieved of their duties and liabilities, including any liabilities under section 114, to the same extent.
>
> * * *
>
> 1(z) "unanimous shareholder agreement" means
>
> (i) a written agreement to which all the shareholders of a corporation are or are deemed to be parties, whether or not any other person is also a party, or
>
> (ii) a written declaration by a person who is the beneficial owner of all the issued shares of a corporation,
>
> that provides for any of the matters enumerated in section 140(1).

A myriad of specific powers are expressly vested in the directors by various provisions of the *BCA*. These include the following: making by-laws (s. 99(1)(a)); appointing officers (s. 116); fixing the remuneration of directors, officers and employees (s. 120); borrowing money, issuing, reissuing, selling or pledging debt obligations, and creating security interests (s. 98.1); dissolving a corporation with no issued shares, or property or liabilities (s. 203(1)); proposing the voluntary liquidation of the corporation (s. 204(1)); authorizing payment of a commission on the sale of shares (s. 39); fixing record dates for determining shareholders entitled to receive dividends, to participate in a liquidation distribution, or to receive notice of a meeting (s. 128); specifying the time for deposit of proxies (s. 142(5)); calling special meetings of shareholders (s. 127(1)(b)); attaching conditions to scrip certificates (s. 45(13)); signing a certificate stating facts concerning the corporation (s. 250(1)); certifying compliance with the terms of a trust indenture (s. 82); and, proposing amendments to the cor poration's articles (s. 169).

Directors exercise their powers either directly or through managers appointed by them. The distribution of powers between the staff and the board of directors is, according to Romer, J. "a business matter to be decided on business lines." He prefaced that comment by saying, "The larger the business carried on by the company the more numerous, and the more important, the matters that must of necessity be left to the managers, the accountants and the rest of the staff." *In Re City Equitable Fire Insurance Company Limited*, [1925] 1 Ch. 407 (C.A.) at 426-427.

The *BCA* regulates the delegation of directors' powers in ss. 116 and 110(3), which provide as follows:

116 Subject to the articles, the by-laws or any unanimous shareholder agreement,

(a) the directors may designate the offices of the corporation, appoint as officers individuals of full capacity, specify their duties and delegate to them powers to manage the business and affairs of the corporation, except powers to do anything referred to in s. 110(3),

(b) a director may be appointed to any office of the corporation, and

(c) 2 or more offices of the corporation may be held by the same person.

* * *

110(3) Notwithstanding subsection (1), no managing director and no committee of directors has authority to

(a) submit to the shareholders any question or matter requiring the approval of the shareholders,

(b) fill a vacancy among the directors or in the office of auditor,

(c) issue securities except in the manner and on the terms authorized by the directors,

(d) declare dividends,

(e) purchase, redeem or otherwise acquire shares issued by the corporation, except in the manner and on the terms authorized by the directors,

(f) pay a commission referred to in section 39,

(g) approve a management proxy circular referred to in Part 12,

(h) approve any financial statements referred to in section 149, or

(i) adopt, amend or repeal by-laws.

Whereas shareholders may vote out directors and may restrict their powers as aforesaid, the reality is that most of a corporation's powers are vested in the board of directors.

3. DUTIES OF DIRECTORS

Duties accompanying directors' powers fall into two categories: fiduciary duties and duties of care, skill and diligence.

Directors assume ". . . a position involving duties which cannot be shirked by leaving everything to others" *Drincqbier* v. *Wood*, [1899] 1 Ch. 393 (Ch. D.) *per* Byrne, J. Nor is a director who is appointed to the board of a subsidiary by the parent corporation able to avoid the statutory and common law duties of directorship. Viscount Simonds explained the point in *Scottish Co-operative Wholesale Society, Ltd.* v. *Meyer*, [1958] 3 All E.R. 66 (H.L.) and in the course of his reasons stated at 71:

> . . . nominees of a parent company on the board of a subsidiary company may be placed in a difficult and delicate position. It is then the more incumbent on the parent company to behave with scrupulous fairness to the minority shareholders and to avoid imposing on their nominees the alternative of disregarding their instructions or betraying the interests of the minority. In the present case, the society pursued a different course. It was ruthless and unscrupulous in design, and it was effective in operation, and, as I have said, it was prompted by the action or inaction of the nominee directors. . . .

The parent corporation's duty to behave toward its subsidiary with scrupulous fairness does not absolve directors of discharging their duties. In that regard Lord Keith stated at 85-86:

> . . . But I cannot think that, where directors, having power to do something to save a company, lie back and do nothing, they are not conducting the affairs of the company, perhaps foolishly, perhaps negligently, perhaps with some ulterior object in view. They are certainly conducting the affairs of the company in breach of their duty as directors. . . .

A director of two corporations which deal with each other owes a fiduciary duty to each of them to act in the best interests of the corporation and not exercise any powers in such a way as to benefit personally at the expense of the remaining shareholders. *See*: *Whittall* v. *M.N.R.*, [1964] C.T.C. 417 (Exch.).

(a) **Care, Diligence and Skill**

The basis of the fiduciary duties of directors is stated by Gower, *Modern Company Law* (1979, 4th ed.) (hereafter "Gower") at 575 as the following general principle: "Directors, once their appointments take effect, are fiduciaries and must therefore display the utmost good faith towards the company in their dealings with it or on its behalf." But, as he explains at 602, ". . . there is a striking contrast between the directors' heavy duties of loyalty and good faith and their very light obligations of skill and diligence. Here . . . the trustee analogy breaks down, for the type of skill required of a cautious trustee is quite different from that which an enterprising director needs to display."

The *BCA*, s. 117(1)(b) requires that in exercising their powers and discharging their duties directors and officers shall "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."

Whatever the difference between prudence and care, the objective standard of a reasonably prudent person in comparable circumstances is apparently more onerous than the subjective common law standard of ". . . such care as is reasonably to be expected from him, having regard to his knowledge and experience" as expressed in *In Re Brazilian Rubber Plantations and Estates, Limited*, [1911] 1 Ch. 425 (Ch. D.) *per* Neville, J. at 437. The common law duty was expounded upon in *In Re City Equitable Fire Insurance Company Limited*, *supra*, as follows at 427-429:

> . . . In discharging the duties of his position . . . a director must, of course, act honestly; but he must also exercise some degree of both skill and diligence. To the question of what is the particular degree of skill and diligence required of him, the authorities do not, I think, give any very clear answer. It has been laid down that so long as a director acts honestly he cannot be made responsible in damages unless guilty of gross or culpable negligence in a business sense. . . . If, therefore, a director is only liable for gross or culpable negligence, this means that he does not owe a duty to his company, to take all possible care. It is some degree of care less than that. . . .
>
> There are . . . one or two other general propositions that seem to be warranted by the reported cases: (1.) A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. . . . It is perhaps only another way of stating the same proposition to say that directors are not liable for mere errors of judgment. (2.) A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so. (3.) In respect of all duties that, having regard to exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly. . . .

(b) **Fiduciary Duties**

The *BCA*, s. 117(1)(a) requires that in exercising their powers and discharging their duties directors and officers shall "act honestly and in good faith with a view to the best interests of the corporation." Gower notes at 575 that as the Jenkins Committee pointed out (Cmnd. 1749, para. 86):

> . . . legislation has to some extent extended and clarified the ambit of [directors' fiduciary] duties, but in the main these are still "determined by extensive and complex case-law which does not find expression in the Act".

Directors' duties of good faith are owed by each director individually and are owed ". . . to the company and to the company alone": Gower at 572-573. There are four facets of the general principle — albeit they tend to overlap, as the ensuing discussion of each facet under separate headings shows.

(i) *Bona Fides*

Lord Greene, M.R. stated in *Re Smith and Fawcett Ltd.*, [1942] Ch. 304 (C.A.) at 306 that directors are required to act "bona fide in what they consider — not what a court may consider — is in the interests of the company and not for any collateral purpose."

Berger, J. proceeded from the foregoing proposition in *Teck Corporation Limited et al* v. *Millar et al*, [1973] 2 W.W.R. 385 (B.C.S.C.) to state as follows at 413-414:

> If the directors have the right to consider the consequences of a take over, and to exercise their powers to meet it, if they do so *bona fide* in the interest of the company, how is the court to determine their purpose? In every case the directors will insist that their whole purpose was to serve the company's interest. And no doubt in most cases it will not be difficult for the directors to persuade themselves that it is in the company's best interests that they should remain in office. Something more than a mere assertion of good faith is required.
>
> How can the court go about determining whether the directors have abused their powers in a given case? How are the courts to know, in an appropriate case, that the directors were genuinely concerned about the company and not merely pursuing their own selfish interests? . . . . .
>
> I think the courts should apply the general rule in this way: The directors must act in good faith. Then there must be reasonable grounds for their belief. If they say that they believe there will be substantial damage to the company's interests, then there must be reasonable grounds for that belief. If there are not, that will justify a finding that the directors were actuated by an improper purpose.

(ii) *Proper Purposes*

Gower states at 580 that:

> If directors exercise their powers for purposes other than those for which they were conferred, it may be said that they have exceeded their authority and are liable accordingly. But it probably makes for clarity to distinguish between an act *ultra vires* the directors because they have usurped a power which they never had, and an act which *prima facie* is within the powers delegated to them but which they have abused by exercising it for an improper purpose. The former hardly seems to be a breach of the fiduciary duty of good faith; the latter is.

Angus v. *R. Angus Alberta Limited* (1988), 58 Alta. L.R. (2d) 76 (C.A.) seems to take a slightly different view. The case was decided under the *Companies Act*, R.S.A. 1980, c. C-20. The directors were being sued for reimbursement of funds expended pursuant to an *ultra vires* act. The court stated at 90:

> . . . The respondent directors do not seriously take issue with this rule of liability of the directors. They argue that honesty and good faith as found by the trial judge is a defence to the action against the directors for reimbursement.
>
> The learned trial judge exonerated the directors from personal liability on the grounds that they had acted honestly on the basis of advice from legal counsel. The authorities cited in support of the trial judge's decision are cases involving imprudence, not *ultra vires* acts. The test for exoneration in cases involving breach of duty of care is not the test to be applied in the case of misapplication by directors of company funds in a manner and for a purpose which is *ultra vires* the company and incapable of ratification by the shareholders. Such misapplication being a breach of trust, honesty and good faith will not relieve from liability to reimburse unless it be, if at all, under the *Trustee Act*.

A purpose that is illegal or contrary to public policy will render the impugned action ineffective on that ground rather than as a breach of the fiduciary duty, as demonstrated in *Pharmaceutical Society* v. *Dickson*, [1970] A.C. 403 (H.L.), a case where the purpose was in restraint of trade, which offends public policy.

In *Exco Corporation* v. *Nova Scotia Savings & Loan Company* (1987), 35 B.L.R. 149 (N.S.S.C.) a share issue designed to abort a take-over was held to contravene the company's charter and to show *mala fides*. At 261-262 Richard, J. said as follows:

> . . . When exercising their power to issue shares from treasury, the directors must be able to show that the considerations upon which the decision to issue was based are consistent only with the best interests of the company and inconsistent with any other interests. This burden ought to be on the directors once a treasury share issue has been challenged. I am of the view that such a test is consistent with the fiduciary nature of the director's duty, in fact, it may be just another way of stating that duty. . . .

● ● ● ● ●

> . . . What the directors did in this case is more consistent with a finding of self-interest than with *bona fide* company interest. Or, to put it more in the context of the test which I previously set out, what the directors did was not inconsistent with self-interest. In so doing they breached their fiduciary duty to the general body of the shareholders.

(iii) *Unfettered Discretion*

Bona fides and the exercise of directors' powers for proper purposes are subjective standards. Conflict of interest and duty and refraining from fettering discretion are objective standards. Gower at 582 makes the point about unfettered discretion as follows:

> Since the directors' powers are held by them in trust for the company they cannot, without the consent of the company, fetter their future discretion. Thus it seems clear as a general principle, despite the paucity of reported cases on the point, that directors cannot validly contract (either with one another or with third parties) as to how they shall vote at future board meetings. This is so even though there is no improper motive or purpose (thus infringing the previous rules) and no personal advantage reaped by the directors under the agreement (thus infringing the succeeding rule).

(iv) *Conflict of Duty and Interest*

Gower states at 576-577 that despite compliance with the rules discussed above, directors ". . . must not, without the consent of the company, place themselves in a position in which there is a conflict between their duties and their personal interest."

Competing with the company and contracting with the company are common means by which a director lands in a conflict situation. Lord Cranworth, L.C. said in *Aberdeen Ry.* v. *Blaikie* (1854), 1 Macq. H.L. 461 (H.L. Sc.), a case impugning a contract, at 471- 472 as follows:

> A corporate body can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect.
>
> So strictly is the principal adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. . . .

The third common circumstance in which a conflict of interest may present itself is where the director makes use of corporate property, information or opportunity for non-corporate ends. *Canadian Aero Services Ltd.* v. *O'Malley et al.*, [1974] S.C.R. 592 (hereafter "*CanAero*") is a leading authority. Laskin, J., as he then was, reviewed the cases and stated as follows at 607-608:

> An examination of the case law in this Court and in the Courts of other like jurisdictions on the fiduciary duties of directors and senior officers shows the pervasiveness of a strict ethic in this area of the law. In my opinion, this ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company, or where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired.

Laskin, J. invoked "certain general statements of law by Viscount Sankey and Lord Russell of Killowen in *Regal (Hastings) Ltd.* v. *Gullineg*, [1942] 1 All E.R. 378 at pp. 381 and 389". *Zwicker* v. *Stanbury*, [1953] 2 S.C.R. 438 relied on the same authority. Laskin, J. quoted the following passage from the reasons of Lord Russell of Killowen:

> In the result, I am of opinion that the directors standing in a fiduciary relationship to Regal in regard to the exercise of their powers as directors, and having obtained these shares by reason and only by reason of the fact that they were directors of Regal and in the course of the execution of that office, are accountable for the profits which they have made out of them. The equitable rule laid down in *Keech* v. *Sandford* ((1726), Sel. Cas.61) and *Ex p. James* ((1803), 8 Ves. 337), and similar authorities applies ... in full force. It was contended that these cases were distinguishable by reason of the fact that it was impossible for Regal to get the shares owing to lack of funds, and that the directors in taking the shares were really acting as members of the public. I cannot accept this argument. It was impossible for the *cestui que trust* in *Keech* v. *Sandford* to obtain the lease, nevertheless the trustee was accountable. The suggestion that the directors were applying simply as members of the public is a travesty of the facts. They could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of the Regal shareholders in general meeting. In default of such approval, the liability to account must remain.

Laskin, J. set out Viscount Sankey's statement that "the general rule of equity is that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interests of those whom he is bound to protect". Laskin, J. stated at 608-609:

> In my opinion, neither the conflict test, referred to by Viscount Sankey, nor the test of accountability for profits acquired by reason only of being directors and in the course of execution of the office, reflected in the passage quoted from Lord Russell of Killowen, should be considered as the exclusive touchstones of liability. In this, as in other branches of the law, new fact situations may require a reformulation of existing principle to maintain its vigor in the new setting.

(v) *Saving Provision*

The duties of honesty and good faith and care, skill and diligence codified in s. 117(1) of the *BCA* are tempered by s. 118(3), which provides as follows:

> A director is not liable under section 113 [concerning personal liability of directors] or 117 if he relies in good faith on:
>
> (a) financial statements of the corporation represented to him by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation, or
>
> (b) an opinion or report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him.

4. OPPRESSION AND IMPUGNED UNFAIRNESS

Directors have a duty to exercise their powers in the best interests of the corporation but not in a manner which is "oppressive", "unfairly prejudicial to" or which "unfairly disregards" the interests of security holders as contemplated in the *BCA*, s. 223.

The words "oppressive or unfairly prejudicial" in s. 207 of the *BCA* were considered in *Keho Holdings Ltd. and Oliver* v. *Noble* (1987), 52 Alta. L.R. (2d) 195 (C.A.) followed in *Stech* v. *Davies* (1987), 80 A.R. 298 (Q.B.). *Stech* considered the phrase "oppressive or unfairly prejudicial to or that unfairly disregards" in s. 234(2) of the *BCA*. The court stated at 302 that "The applicable parts of the wording of section 207 and section 234 are basically identical so the remarks of the Court of Appeal [in *Keho*] would likewise apply to section 234 . . .". The words appear substantially in s. 223(2)(b) of the *BCA* and paragraph 7.1(c) of the orders of July 29, 1987, as amended, and so their judicial construction in the context of the other sections of the *BCA* are a guide to their construction in this context.

"Oppressive" was defined in *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer*, *supra*, by Viscount Simonds at 71 as follows:

> . . . It appears to me incontrovertible that the society have behaved to the minority shareholders of the company in a manner which can justly be described as oppressive. It had the majority power and it exercised its authority in a manner "burdensome, harsh and wrongful" — I take the dictionary meaning of the word. . . .

(The definition was relied upon in *Re National Building Maintenance*, [1971] 1 W.W.R. 8 (B.C.S.C.) at 21-22 affirmed [1972] 5 W.W.R. 410 (C.A.); and *Re Cucci's Restaurant* (1985), 61 A.R. 219 (Q.B.) at 223.)

In his reasons Lord Keith, in considering the meaning of "oppressive", stated at 86:

> . . . It suggests to my mind, as I said in *Elder* v. *Elder & Watson* (1952 S.C. 49), a lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members. . . .

In *Keho* Haddad, J.A. quoted Lord Keith's definition and stated at 200-201:

> In preparing proposals for the present legislation both the federal and provincial law reform agencies refer to and were guided by the standards reflected by Lord Cooper's words in *Elder* v. *Elder & Watson Ltd.*, [1952] S.C. 49 at 55. I quote:
>
> > ". . . the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely."

> (See Institute of Law Research and Reform Report No. 36., *Proposals for a New Business Corporations Act*, Vol. 1)

(This passage was applied in *Stech.*)

Diligenti v. *Winchester Oil and Gas Inc.* (1976), 1 B.C.L.R. 36 (S.C.) considered new wording of the British Columbia *Companies Act* providing a remedy for acts of a company which were "unfairly prejudicial to one or more of its members". After adopting the definition of "oppressive" set down in *Meyer* Fulton, J. stated at 45-46:

> There has been no interpretation, in this context, of the words "unfairly prejudicial". Turning to the dictionaries for assistance, I find the following definitions in the Shorter Oxford English Dictionary, 3rd ed.:
>
> > "Prejudice" . . . I. Injury, detriment, or damage, caused to a person by judgment or action in which his rights are disregarded; hence, injury to a person or thing likely to be the consequence of some action . . .
> >
> > "Prejudicial" . . . I. Causing prejudice; detrimental, damaging (to rights, interests, etc.) . . .
> >
> > "Unfair . . . Not fair or equitable; unjust . . . Hence, unfairly."
>
> It is significant that the dictionary definitions support the instinctive reactions that what is unjust and inequitable is obviously also unfairly prejudicial.
>
> In considering the whole effect which should be given to the expression "unfairly prejudicial" in the light of these definitions, and of the rule summarized above, I agree that it must be borne in mind that the consequences in question must flow to the applicant as a member, and not as a director or employee. Prejudicial, according to the dictionary, means detrimental or damaging to his rights, interests, etc. The question then is: does the applicant have some rights or interests as a shareholder in respect of which he had been unfairly prejudiced?

In *Stech* Egbert, J. defined "unfairly disregards" at 302 as follows:

> . . . To unjustly or without cause, in the context of section 234(2), pay no attention to, ignore or treat as of no importance the interests of security holders, creditors, directors or officers of a corporation.

The test for unfairness is less stringent than the traditional test of oppressive conduct (meaning "burdensome, harsh and wrongful"). In *First Edmonton Place Limited* v. *315888 Alberta Ltd.* (1988), 60 Alta. L.R. (2d) 122 (Q.B.) it is stated at 140-141:

> The addition of "unfairly prejudicial" and "unfairly disregards" to "oppressive" gives the court a broad basis upon which to apply notions of equity and fairness to the conduct of the directors and the majority. . . . the notion of "unfair prejudice" is "not merely a relaxation of the term oppression" and in "important respects it is its antithesis". Clearly, the addition of "unfairly prejudicial" and "unfairly disregards" puts the court in a position to judge the fairness of the actions of management . . .

Nystad v. *Harcrest Apartments Limited et al.* (1986), 3 B.C.L.R. (2d) 39 (S.C.) differentiated between "oppressive conduct" and "unfairly prejudicial" conduct at 47 in the following terms:

> Whereas the focus with regard to "oppression" is on the character of the conduct complained of, it is apparent from the judgment of Lord Wilberforce [in *Ebrahimi* v. *Westbourne Galleries*, [1972] 2 All E.R. 492 (H.L.)] that the focus with regard to the "just and equitable provision" (in our Act "unfairly prejudicial") is on the effect on the injured shareholder of the impugned conduct.

After quoting Viscount Sankey's conflict test relied upon by Laskin, J. in *CanAero* and set out above, *Redekop* v. *Robco Construction Ltd.* (1978), 89 D.L.R. (3d) 507 (B.C.S.C.) held that, "Even good faith, then, does not exonerate a person where his self interest is in conflict with the interests of those whom he is bound to protect".

Having characterized as oppressive the conduct of a director (who was also majority shareholder) in negotiating a contract or on behalf of the corporation with another corporation in which he was interested, without complying with the statutory disclosure provisions, the court continued as follows at 515:

> Mr. Promislow has said that there is no rule against a person being a director and participant in two companies. This passage from the judgment of Lord Denning in the *Scottish Co-operative* case at p. 88 is appropos:
>
> > Your Lordships were referred to *Bell* v. *Lever Bros., Ltd.* ([1932] A.C. 161 at p. 195), where LORD BLANESBURGH said that a director of one company was at liberty to become a director also of a rival company. That may have been so at that time. But it is at the risk now of an application under s. 210 if he subordinates the interests of the one company to those of the other.
>
> Robco and C.F.R. may not be, strictly speaking, "rival" companies. But the interest of Robillard in the two companies did conflict. If Robillard chose to serve two conflicting interests he ran the risk of the present application.

While it was said in *Redekop* that the impugned conduct need not be carried out in bad faith, *Re Ferguson and Imax Systems Corp.* (1983), 150 D.L.R. (3d) 718 (Ont. C.A.), leave to appeal to S.C.C. denied (1983), 52 N.R. 317, held at 727, in considering s. 241 (formerly s. 234) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, that while what is oppressive or unfairly prejudicial conduct will turn on the facts of each case, a "Court must consider the *bona fides* of the corporate transaction in question to determine whether the act of the corporation or directors effects a result which is oppressive or unfairly prejudicial to the minority shareholder . . . ."

In *Brant Investments Ltd. et al and KeepRite Inc. et al* (1987), 42 D.L.R. (4th) 15 (Ont. H.C.) a minority shareholder alleged oppression on the part of the majority shareholder (itself a corporation), which owned 60% of the company, on the basis of an agreement between the company and a subsidiary of the majority shareholder whereby the assets of the latter would be purchased and the business of the two entities would be integrated.

The dissenting shareholder complained that he was not kept informed of relevant and material matters, and that he was not informed of the critical state of their banking arrangements. Anderson, J. found nothing wrong with the transaction. He stated as follows at 47:

> The record does not establish any of the grounds of oppression enumerated in s. 234(2). There were valid corporate purposes for the transaction. Reasonable steps were taken to simulate a transaction at arm's length. No want of good faith on the part of the directors has been shown. The transaction did not discriminate between shareholders with the effect of benefiting the majority to the exclusion or detriment of the minority. There was adequate and appropriate disclosure of material information. The critical state of the balance sheet was addressed and a crisis with the bankers was averted.
>
> Not only has no oppression been shown, I have difficulty in seeing *any* prejudicial effect on, or disregard of, the interests of the minority. The impugned transaction was proposed by the directors of KeepRite because, in their judgment, honestly and fairly exercised, it was for the benefit of KeepRite. The dissenting shareholders concluded otherwise. They could have bowed to the decision of the board. They chose not to and exercised their right to dissent. If detriment or prejudice to them is involved, it is well within the ambit of that which may be imposed upon a minority shareholder without calling for judicial intervention.

Anderson, J. rejected the submission that there was a fiduciary duty owed by the majority to minority shareholders, stating as follows at 39:

> . . . The provisions of s. 234 curtail the rights and powers of the majority only to the extent expressly provided, and by implication recognize that such rights and powers may be exercised to the prejudice of the minority (if not unfairly), and may disregard the interests of the minority (if not unfairly), a position inconsistent with a fiduciary duty.

Anderson, J. expressed skepticism that is not atypical, about the role of bad faith in oppression. He reasoned as follows at 45:

> It has been submitted that the granting of the oppression remedy does not require a finding that there has been a want of probity in those responsible for the impugned conduct; that oppression in the result is sufficient. As to that, I have a measure of skepticism. When one examines the facts in the decisions to which I have been referred, in which remedy was granted, there is always a finding of conduct clearly inconsistent with good faith and honesty.

After quoting Brooke, J.A. in *Imax* in the terms set out above about the need to "consider the *bona fides* of the corporate transaction", he continued at 45-46:

> *Cumberland Holdings Ltd.* v. *Washington H. Soul Patinson & Co. Ltd.* (1977), 2 A.C.L.R. 307, was a case involving, among other matters, a petition that the affairs of the company were being conducted in a manner oppressive to one or more of the members. In the judgment of the Privy Council at p. 318 is the following:
>
>> They failed to make good a case of oppression or of unfair and unjust conduct in the company's affairs. They did not succeed in showing that Mr. Adler or Mr. Belfer had acted in the affairs of CHL (even giving those words a wide construction) in their own interests rather than in the interests of the members as a whole. They did not succeed in establishing lack of probity of the directors of CHL in the conduct of the company's affairs. They did not succeed in showing that FAR or FAI intended either to squeeze out the minority of CHL or to freeze it in.
>
> In *H.J. Rai Ltd. et al.* v. *Reed Point Marina Ltd. et al.*, May 26, 1981, B.C. Supreme Court (unreported [summarized 9 A.C.W.S. (2d) 216]), in dismissing a petition under the oppression section of the *Company Act*, R.S.B.C. 1979, c. 59, Skipp L.J.S.C. says, at p. 11 of the typescript:
>
>> Section 224 does provide the jurisdiction but, in my view, the legislation was not intended to diminish but to temper the ordinary presumption of majority rule. The situation before me indicates certain directors with a view as to what must be done to ameliorate the financial plight of the company, which view is not concurred with by the petitioners. I do not find *mala fides* on the part of the respondents not [sic] in any of the situations herein before discussed and advanced by the petitioners and I, therefore, decline to make an order pursuant to s. 224(2)(a), (b), (c), (f) or (g).

In *Bank of Montreal* v. *Dome Petroleum Limited and Amoco Canada Petroleum Company Ltd.* (1987), 54 Alta. L.R. (2d) 289 (Q.B.) Forsyth, J. expressed sympathy for the views of Anderson, J. in *Brant*, as follows at 299-300:

> I have commented on the absence of any allegation or inference that suggests *mala fides* or lack of probity on the part of the directors or managers of Dome. I do not for the purpose of this application have to determine that a finding of *mala fides* or lack of probity is a condition precedent to awarding relief under s. 234 of the C.B.C.A., but I would note that I am very sympathetic to a comment by Mr. Justice Anderson in the *Keeprite* case . . .
>
> The learned justice in that case referred to several authorities, most of which have been submitted to this court, including: *Re Ferguson and Imax Systems Corp.* (1983), 43 O.R. (2d) 128 at 137, 150 D.L.R. (3d) 718 (C.A.); *Cumberland Hldg. Ltd.* v. *Washington H. Soul Pattinson & Co.* (1977), 2 A.C.L.R. 307 at 318, 13 A.L.R. 561 (P.C.); and *H.J. Rai Ltd.* v. *Reed Point Marina Ltd.*, B.C.S.C., 26th May 1981, not reported.

> To that list I would add the recent Court of Appeal of Alberta decision *Keho Hldg. Ltd.* v. *Noble*, Alberta Court of Appeal, 27th April 1987 [now reported at 52 Alta. L.R. (2d) 195, 78 A.R. 131], and in particular the comments of Mr. Justice Haddad, who wrote the decision for the court, at p. 8 [p. 201 Alta. L.R.] where he refers to a passage from *Re Ferguson and Imax Systems Corp.*, where Mr. Justice Brooke states:
>
> > In addition, the court must consider the *bona fides* of the corporate transaction in question to determine whether the act of the corporation or directors effects a result which is oppressive or unfairly prejudicial to the minority shareholder.

Haddad, J.A. set out the correct approach to evaluating fairness in *Keho* at 201 in the following terms:

> In my view the following extract taken from the reasons for judgment of Brooke J.A. in *Re Ferguson and Imax Systems Corp.* (1984), 150 D.L.R. (3d) 718; 43 O.R. (2d) 128, leave to appeal to S.C.C. refused 2 O.A.C. 158, 52 N.R. 317, presents a model of the principles to be employed in evaluating fairness:
>
> > The policy of the law to ensure just and equitable treatment of minorities can be traced back to early cases. In *Allen* v. *Gold Reefs of West Africa, Ltd.*, [1900] 1 Ch. 656 at p. 671, Lindley M.R., speaking of the powers of the corporation to amend its articles, said:
> >
> > > '. . . it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also *bona fide* for the benefit of the company as a whole, and it must not be exceeded.'
> >
> > In *Goldex Mines Ltd.* v. *Revill et al.* (1974), 7 O.R. (2d) 216 at p. 224, 54 D.L.R. (3d) 672 at p. 680, Arnup J.A., for this court, after considering the earlier cases, said:
> >
> > > 'The principle that the majority governs in corporate affairs is fundamental to corporation law, but its corollary is also important — that the majority must act fairly and honestly. Fairness is the touchstone of equitable justice and when the test of fairness is not met, the equitable jurisdiction of the court can be invoked to prevent or remedy the injustice which misrepresentation or other dishonesty has caused.'
> >
> > But s. 234 must not be regarded as being simply a codification of the common law. Today one looks to the section when considering the interests of the minority shareholders and the section should be interpreted broadly to carry out its purpose: see the *Interpretation Act*, R.S.C. 1970, c. I-23, s. 11. Accordingly, when dealing with a close corporation, the court may consider the relationship between the shareholders and not simply legal rights as such. In addition, the court must consider the *bona fides* of the corporate transaction in question to determine whether the act of the corporation or directors effects a result which is oppressive or unfairly prejudicial to the minority shareholder. Counsel has referred us to a number of decisions. They establish primarily that each case turns on its own facts. What is oppressive or unfairly prejudicial in one case may not necessarily be so in the slightly different setting of another.
>
> I concur, without hesitation, that these sections ought to be broadly and liberally interpreted. A broad interpretation will reflect the intention of the legislation to ensure settlement of intra-corporate disputes on equitable principles as opposed to adherence to legal rights. . . .

The reasons in *First Edmonton Place, supra* list some relevant factors in assessing fairness, stating as follows at 146:

> . . . In deciding what is unfair, the history and nature of the corporation, the essential nature of the relationship between the corporation and the creditor, the type of rights affected and the general commercial practice should all be material. More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations: the protection of the underlying expectation of a creditor in its arrangement with the corporation,

> the extent to which the acts complained of were unforeseeable or the creditor could reasonably have protected itself from such acts, and the detriment to the interests of the creditor. . . .

In *Re Abraham and Inter Wide Investments Ltd. et al.* (1985), 51 O.R. (2d) 460 (H.C.) the court considered an application by a minority shareholder to be paid fair value for his shares, on the basis that the directors' powers were exercised in a manner that was oppressive or unfairly prejudicial to the shareholder. The application was granted on the basis that the directors had paid themselves unauthorized directors' and consulting fees. Such unauthorized payments were an act which had the effect of unfairly decreasing the value of the corporation in favour of the director shareholders at the expense of the applicant shareholder. Concerning directors' fees Griffiths, J. stated at 469:

> The report of the inspector and the opinion of the accountant Ernest A. Purkis supports that finding. The payments to directors characterized as directors' fees were not authorized at law and according to the inspector those fees did not have the character of directors' fees and did not appear to be associated with the duties and responsibilities of directors. Some fees were paid to corporations as directors' fees although a corporation clearly cannot qualify as a director.
>
> The findings of the inspector in my view raise a *prima facie* question as to the validity of some of the automobile expenses paid to directors. Further, there is evidence that the financial statements of Inter Wide are inadequate, inaccurate and not prepared in accordance with generally accepted accounting principles and that there have been breaches of the *Income Tax Act*. In my opinion these serious departures by the directors from legal and normal business-like practices are sufficient to establish a case of conduct that is both unfairly prejudicial and has the effect of unfairly disregarding the interests of Mr. Abraham.

In *Low and Anderson* v. *Ascot Jockey Club Limited et al.* (1986), 1 B.C.L.R. (2d) 123 (S.C.) the minority shareholders brought a petition for relief from oppression pursuant to s. 224 of the *Companies Act* (B.C.). The petitioners had become minority shareholders of the respondent A. Ltd., a private company, pursuant to an agreement made with the respondents. The respondent Randall owned most of the other shares of A. Ltd. The principal asset of A. Ltd. was a one-half interest in a profitable partnership which operated a race track. Upon receiving the 1984 financial statements for A. Ltd., the petitioners noted that the respondent Randall had been paid $480,000 under the heading "Management Salaries and Bonus". In addition, A. Ltd. had made substantial unsecured interest-free loans to others. The court in granting the petition stated at 130:

> Before April 1984 Mr. Randall required only the assent of his son to his siphoning off of the profits as bonuses and management fees. The company had no creditors to speak of and such a method of distributing profits does not appear to upset Her Majesty's revenue.
>
> Once, however, the petitioners became shareholders, such a course of action was no longer permissible. That Mr. Randall was and is entitled to substantial remuneration for his services, I do not doubt. But half a million dollars a year would be considered generous for a chief executive officer of one of Canada's larger corporations.
>
> Whether if the board of directors resolve to pay such amounts the resolution could be attacked, I do not decide. In this case, there is no evidence of any resolution in 1984 to fix the remuneration or of a resolution in 1985 to pay it. The evidence leads irresistibly to the conclusion that, having had such remuneration in the past, Mr. Randall, Sr. considered he was entitled to go on receiving it by the simple expedient of the the accountants making the appropriate entries in the 1984 financial statements.
>
> Such a course of conduct is oppressive within s. 224(1)(a).
>
> As to the failure by the company to insist on receiving interest on all the loans from the date of the settlement, I agree that failure was also oppressive for the effect was to c[illegible]er a benefit upon one branch of the family to the exclusion of the petitioners.

In *Re National Building Maintenance Ltd.*, *supra*, the petitioner owned ⅓ of the common shares of the company and ⅔ were owned by Lee, a chartered accountant who had managed all the company's financial affairs. The petitioner sought relief pursuant to s. 185 of the *Companies Act* (B.C.) in the form of an order that Lee buy all of the petitioner's shares on the ground that Lee was conducting the affairs of the company in a manner oppressive to the petitioner as a shareholder. The petitioner alleged that Lee had secretly and wrongfully paid or authorized payment to himself of management fees for past years in a total sum in excess of $100,000 and that he had thus reduced the value of the shareholders' equity in the company to a low figure to enable him to acquire the petitioner's shares at a price far below their true worth. In the alternative, the petitioner sought a winding-up order pursuant to s. 219 on the ground that it was just and equitable.

Aitkens, J. concluded that the conduct was oppressive and stated at 25:

> I now go on to consider Mr. Lee's conduct in taking management fees for the years 1966 to 1969 inclusive, in the amounts given earlier in these reasons. These fees were taken secretly; he did not tell Mr. Dove what he was doing. Mr. Lee had no right to the money he took. It was open to Mr. Lee to have availed himself of proper company procedures to obtain authorization for management fees to be paid to him. He did not do so. *Thomson* v. *Drysdale*, [1925] S.C. 311, is a case in which the petitioner invoked the just and equitable rule and sought a winding-up order; nevertheless what was said by Lord Clyde at p. 315 is of assistance in assessing Mr. Lee's conduct in the present matter. Lord Clyde said:
>
> > "Now, in any case in which the shareholders who hold a preponderating interest in a company make it manifest that they intend to set at naught the security provided by company procedure, and to treat the company and its affairs as if they were their own property, it is impossible that the minority should retain any confidence in the impartiality or probity of the company's administration, and according to the circumstances of each particular case it becomes a question whether the minority are not entitled, as a matter of "justice and equity" . . . to have the company wound up."
>
> It seems to me beyond question that Mr. Lee totally disregarded the security provided to minority shareholders by company procedures and in effect dealt with the company's money as if it were his own. There was clearly a lack of probity on the part of Mr. Lee because he did this secretly. He had the conduct of the company's financial affairs: his conduct in taking money from the company to which he had no right was oppressive to Mr. Dove as a shareholder. That this is so is sufficiently obvious that it does not require elaborate exposition. It is enough to say that on each occasion that Mr. Lee took money from the company to which he had no right the effect was to reduce the value of Mr. Dove's shares and Mr. Lee's conduct was, therefore, oppressive to Mr. Dove as a shareholder.

The petitioner in *Re Little Billy's Restaurant (1977) Ltd.* (1983), 45 B.C.L.R. 388 (S.C) was a shareholder of and the respondents were majority shareholders and directors of a restaurant company. At an annual general meeting, the respondents approved a franchise agreement obligating the restaurant company to pay a franchise fee to a second company which the respondents owned and controlled and in which the petitioner had no interest. Prior to the franchise agreement being approved the restaurant company had paid the second company a franchise fee. The petitioner applied to have the franchise agreement cancelled pursuant to s. 224 of the *Companies Act* (B.C.). It was stated at 391 that were it not for the fact that the respondents owned and controlled the second company it could not be suggested that the affairs of the restaurant company were conducted "oppressively" or that the members had passed a resolution "that was unfairly prejudicial" to a member. Having discussed the nature of both the directors' and members' duties, the court held at 393:

> In the instant case although the considerations in conflict are not those between legal and personal obligations but rather arise from the conflict between the duties of a person in his role as director and his rights and privileges in his role as a member, I am of the view the same principles apply. The court will subject the exercise of the member's legal rights

> to equitable considerations where they are in conflict with his duties as a director and their exercise would be oppresive [sic] or unjustly prejudicial to one or more members.
>
> In my opinion the resolution of 13th May 1982 passed by the respondents was unfairly prejudicial to the petitioner as a member in that it was designed to, and did, advance the interests of the respondents at the expense of the interests of the petitioner by, in effect, diverting the Restaurant Co.'s funds to the respondents thereby excluding the petitioner from participating in that portion of the restaurant's income. Furthermore, I find the payment of $13,488.22 to the Franchise Co. without authority did unfairly prejudice the petitioner as a member.

See also the discussion in *Jackman* v. *Jackets Enterprises Ltd.* (1977), 4 B.C.L.R. 358 (S.C.).

In *Keho* it was held that the chief executive officer of the corporation caused its affairs to be carried on unfairly and to the prejudice of the corporation and its shareholders. The offending conduct consisted of the chief executive officer having caused the company to borrow money from its bank to lend to a corporation which he wholly owned without requiring that the corporation post securities; and in not obtaining the approval of the board of directors for the loan. The conduct was held to be unfairly prejudicial to the shareholders and the corporation itself. Haddad, J.A. stated at 203-204:

> A disturbing aspect of Oliver's conduct is that he seems to have considered his position beyond challenge by using Keho's line of credit to his personal advantage. He treated Keho as his personal domain. He acted improperly and his conduct can only be characterized as prejudicial to Keho and its shareholders. I agree with the decision handed down by Fulton J. in *Jackman* v. *Jackets Enterprises Ltd.*, [1978] 4 B.C.L.R. 358 at 361. In that case there were only two shareholders. The majority shareholder, acting alone, arranged to borrow a large sum of money on the security of company property and then advanced in excess of $200,000.00, without security, to a company wholly owned by that shareholder. Fulton J. held that to constitute prejudicial conduct.
>
> I conclude then that Oliver's performance does not meet the standard of fairness underlined by Lord Cooper in *Elder* and in the other authorities to which I have referred.

APPENDIX 4

INCOME TAX MATTERS

1. Introduction

The legal framework of tax evasion for the purposes of my Investigation is founded upon certain provisions of the *Income Tax Act*, S.C. 1970-71-72, c. 63, as amended ("*ITA*"). The provisions require a taxpayer to include certain sums in income. They are provisions which might be the subject of evasion, and if so then there is activity which is evidence tending to show dishonest or fraudulent conduct within paragraph 7.1 of my mandate.

2. Income Taxation Provisions

The *ITA* includes provisions respecting the following:

(a) the inclusion in income of loans to shareholders, thereby preventing avoidance of exigibility to tax of fees, salaries and bonuses by cloaking them as loans;

(b) the inclusion in income of deemed interest benefits on loans to employees, thereby preventing avoidance of exigibility to tax of employee benefits by cloaking them as interest-free or low-interest loans;

(c) the inclusion in income of sums properly taxable in the taxpayer's hands but diverted to benefit related parties;

(d) the inclusion provisions curbing contrived reduction of income.

Generally, legitimate tax planning aims to minimize the tax payable without violating the *ITA* or intending to deceive the taxing authorities. Improper tax avoidance can lead to civil tax re-assessment without attracting criminal sanction. At some point, however, the line is crossed and income tax evasion occurs. The inclusions in income material to the discussion are described below.

(a) *Shareholders Loans*

Section 15(2)(b) of the *ITA* provides that where a person is a shareholder of a corporation (and after March 31, 1977, is connected with a shareholder of a corporation) and that person has received a loan from or has become indebted to the corporation or to any corporation related to that corporation, the amount of the loan or indebtedness must be included in computing that person's income unless the loan is repaid within one year from the end of the corporation's taxation year in which the loan was made and the repayment was not made as part of a series of loans or other transactions and repayments.

In respect of loans made after March 31, 1977, a person is connected with a shareholder if that person does not deal at "arm's length" with the shareholder. "Related persons" (i.e., individuals connected by blood relationship, marriage or adoption or corporations with common control) are deemed not to deal with each other at arm's length pursuant to s. 251(1) of the *ITA*. Section 251(1) of the *ITA* also provides that it is a question of fact whether persons not related to each other are dealing with each other at arm's length.

There are a number of exceptions found in s. 15(2)(a) to the shareholder loan rule, but only one of the exceptions has potential relevance to the Investigation. It provides that the loan will not be included in the debtor's income if the loan was made or the indebtedness arose in the ordinary course of the lender's business and, in the case of a loan, the lending of money was part of its ordinary business and *bona fide* arrangements were made at the time the loan was made or the indebtedness arose for repayment thereof within a reasonable time.

With respect to the 1979 and subsequent taxation years, s. 80.4(2) provides that where a person was a shareholder of a corporation or connected with a shareholder of a corporation and by virtue of such shareholding that person received a loan from that corporation (or any other corporation related thereto), the person is deemed to have received an interest benefit in the year equal to the lesser of the rate of interest paid on the debt for the period and the prescribed rate of interest. If the amount of loan is included in income under s. 15(2), then the deemed interest provisions do not apply.

If a taxpayer deals at non-arm's length with a shareholder of a corporation, then loans made by that corporation to the taxpayer must be included in his or her income unless repaid within the applicable time periods provided in s. 15. Where a taxpayer "controls" 2 corporations then those corporations are related pursuant to s. 251(2) and the taxpayer is required to include in income shareholder loans received from either corporation.

The meaning of "arm's length" and "control" for income tax purposes is a complex subject. Certain general principles sufficient for the purposes of the Investigation can be extracted from the jurisprudence in this area. If one party to a transaction has *de facto* control over another party to the transaction or is the "directing mind" of the transaction, the first party, by virtue of that control, becomes the directing mind of both parties, who will thus be viewed as not being at arm's length. In other words, a determination that one person has *de facto* control over another will invariably lead to the conclusion that those two persons are not dealing at arm's length: Susan Eng, "The Arm's Length Rules" (1988), *Report of Proceedings of the 40th Tax Conference*, Tab 36 at 48, and E. Moskowitz, "Dealing at Arm's Length: A Question of Fact"(1987), *Report of Proceedings of the 39th Tax Conference*, 33:1.

A person may have *de facto* control over another person by virtue of his or her general influence over that person or because of some particular advantage that he or she has over that person. The power of a person to control another, not the exercise of that power, is the important factor in establishing *de facto* control. There is no necessity that parties be "dealing" in order for them to be found to be not at arm's length, as long as a relationship of subordination exists between them: Moskowitz, *supra*, at 33:16.

For the purposes of determining whether or not two corporations are related, the concept of common "control" must be analyzed. For tax law purposes, the concept of "control" is narrower than the concept of "arm's length". "Control" means the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors: *Buckerfield's Ltd. et al.* v. *MNR*, 64 D.T.C. 5301 (Exch. Ct.). Although the definition of control as set out in the *Buckerfield's* case has been generally accepted as the test of control, there have been 3 cases where control was found to exist even though the party found to hold control did not have the ability to elect a majority of the board of directors. Each of these cases dealt with situations where a shareholder who did not have voting control of a corporation was found to have some other legal right which put him in control: *Oakfield Developments (Toronto) Ltd.* v. *MNR*, 71 D.T.C. 5175 (S.C.C.); *Donald Applicators Ltd.* v. *MNR*, 71 D.T.C. 5202 (S.C.C.); and *The Queen* v. *Imperial General Properties Limited*, 85 D.T.C. 5500 (S.C.C.).

Apparently there are no cases holding that a non-shareholder has control of a corporation for the purposes of determining whether 2 corporations are related. However, if the non-shareholder has a right under a written or oral contract, in equity or otherwise, present or future, absolute or contingent, to acquire shares in a corporation or to control the voting rights of the shares then the non-shareholder will be deemed to own those shares for the purpose of determining whether or not he controls the corporation: s. 251(5) and Moskowitz, *supra*, at 33:19. Given the jurisprudence it is unlikely that control could be found to exist in a non-shareholder beyond this limited circumstance.

(b) *Officers and Employees Loans*

If a person receives a loan from a corporation by virtue of an office or employment with the corporation, the amount of the loan is not necessarily included in the employee's income. However, s. 80.4(1) requires the employee to include in his or her income a deemed interest benefit to the extent that the interest actually paid on the loan does not exceed the prescribed rate of interest under the *ITA* for a particular period.

"Employee" includes officers and directors. There is no provision equivalent to s. 15(2) which would require the inclusion of an employee loan in income.

(c) *Indirect Payments*

Section 56(2) of the *ITA* provides that a payment or transfer of property made pursuant to or with the direction of, or with the concurrence of, a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other person shall be included in computing the taxpayer's income to the extent as if the payment or transfer had been made to him.

Most of the jurisprudence involving s. 56(2) deals with the redirection of payments such as loans, dividends, gifts or other benefits to a spouse or children of a shareholder. Section 56(2) employs the principle of beneficial receipt; the income is deemed to be that of the person who is beneficially entitled to it rather than that of the person who actually received it.

(d) *Unreasonable or Artificial Expenses*

Section 67 of the *ITA* is designed to place a curb on the contrived reduction of income subject to tax through the deduction of inordinate outlays or expenses (of an otherwise deductible nature) that are wholly under the control of the taxpayer. The determination under this provision is entirely one of fact and the reasonableness of an expenditure will be measured by comparison with other amounts paid in similar circumstances in other businesses of the same kind. In a number of cases the Department of National Revenue, Taxation has relied on this section to disallow the deductibility of salary or management fees to a shareholder or a shareholder's family members.

There are a number of other sections in the *ITA* which deny the deductibility of expenses or disbursements which may unduly reduce the taxpayer's income. These include s. 18(1)(a) which denies the deductibility of expenses to the extent they are not incurred for the purpose of gaining or producing income from a property or a business, and the now repealed s. 245(1) which disallowed deductions resulting in "undue or artificial" deductions in income. The distinction between s. 67 and s. 245(1) is that the former refers to disbursements identifiable as of an otherwise deductible nature and empowers the Department of National Revenue, Taxation to reduce the allowable expense to the extent that the amount thereof is in excess of what is reasonable in the circumstances. Section 245(1) on the other hand envisaged disbursements and expenses whose very existence, and not just quantum, was suspect for income tax purposes.

Thus, deduction of unreasonable salary payments incurred not for the purpose of earning income but rather to unduly or artificially reduce income may be denied. Further, salaries paid to relatives of shareholders may in certain cases be considered indirect gifts or benefits and so s. 56(2) applies.

3. *Tax Evasion*

The offence known as "tax evasion" is established by s. 239(1) of the *ITA*. The section provides:

> (1) Every person who has
>
> (a) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,
>
> (b) to evade payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records of books of account of a taxpayer,
>
> (c) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to entry a material particular, in records or books of account of a taxpayer,
>
> (d) wilfully, in any manner, evaded or attempted to evade, compliance with this Act or payment of taxes imposed by this Act, or
>
> (e) conspired with any person to commit an offence described in paragraphs (a) to (d),
>
> is guilty of an offence . . .

The words "wilfully" and "evade" have been held by the courts to mean "intentionally", "with evil intention" and "avoid by craft, stratagem or artifice": *The Queen* v. *Paveley*, 76 D.T.C. 6415 (Sask. C.A.). Section 239(1)(d) refers to evasion in any "manner". Thus while it has been said that there must be a scheme or artifice, the better view is that the fraud need not involve such artifice or scheme although the presence of such factors may support an inference of guilty intent to evade payment of tax: *Paveley*, *supra*, *per* Brownridge, J.A. and Bayda, J.A.; *The Queen* v. *Medicine Hat Greenhouses Ltd. & German* (1980), 24 A.R. 38 (Prov. Ct.) at 54-57. Mere negligence on the part of the taxpayer is not sufficient to support a conviction: *R.* v. *H.W. Garshman*, 76 D.T.C. 6103 (Alta. Dist. Ct.).

It has been said that a practice widely thought to be legitimate may negate *mens rea* in civil taxation proceedings even if there is significant doubt about its efficacy. In *R.* v. *Armstrong*, 2 W.C.B. 113 (B.C. Co. Ct.), where the accused sought legal and accounting advice and was advised to use a Bahamian corporation through which to carry out investment activity, there was an acquittal. The Bahamian corporation was to be 50% owned by the taxpayer and 50% owned by one of his business associates, also resident in Canada. The directors of the corporation were residents of the Bahamas and all instructions to trade in stock were given by the Bahamian directors. Although the accused advised on the trades, he did not control the management of the corporation. The expert accounting evidence was that the use of such offshore corporations by Canadian residents was very widespread and regarded as perfectly legal. The accused was acquitted at trial. On appeal:

> The learned trial judge was quite justified in finding that there was nothing unlawful about conducting business through offshore corporations, particularly when this was done on assurances from independent professional advisors who gave specific advice as to what must be done. [at 22-3]

In *R.* v. *Redpath Industries Ltd. and Dominion Sugar Co.*, 84 D.T.C. 6349 (Que. S.C.), Bergeron, J. described the guidelines when dealing with civil aspects of a tax assessment (that is, the *actus reus*) in a criminal prosecution:

> A criminal court is not the forum to determine income taxability and to make determinations as to rights to tax assessment or absence of rights of assessment involved. In a tax evasion charge, it must appear *prima facie* from the evidence that the taxability is clear-cut, obvious, indisputable, unquestionable from lack of reporting before entering the examination of the other facts of the charge, e.g., whether the indisputable taxability, based

> on income gained, proven and undeclared, leads to a conclusion beyond a reasonable doubt that it was wilfully omitted by a taxpayer in his tax returns.
>
> If such a basis is not present and there exists an obligation to enter into the examination of the merit of a possible assessment in respect of a declared income in order to weigh whether a taxpayer is susceptible to taxation or not, may or may not take advantage of claimed exemptions, a criminal court usurps its functions and appropriates a jurisdiction which it does not possess. [at 6351]

In *Medicine Hat Greenhouses & German*, *supra*, the corporation and its principal shareholder had been acquitted at trial of charges based on the assertion of the Department of National Revenue, Taxation that certain sums of money in payment of expenses incurred by the shareholder (who was president of the company) and his wife (an officer and director) were not proper business expenses of the corporation, but were taxable benefits conferred upon the shareholder and were not deductible by the corporation. Both defendants were acquitted because it could not be proved beyond a reasonable doubt that certain of the expenses were not incurred for business purposes. The proper tax treatment of other expenses claimed by the corporation and not included in personal income by the shareholder was unclear. There was an "arguable point" in the civil cases, precluding a finding of *mens rea*. The prosecution successfully appealed to the Court of Queen's Bench (unreported), and the taxpayers successfully appealed to the Alberta Court of Appeal, (1981), 26 A.R. 617, leave to appeal denied, 30 A.R. 360 (S.C.C.).

In the Court of Appeal, Harradence, J.A. stressed that s. 239(1)(d) did not *per se* constitute an offence in contravention of the *ITA* with respect to deductibility of expenses or inclusion of taxable benefits. The court held (at 626-7) that the prosecution was required to prove the evasion was wilful. In that case the onus was not met.

In *R.* v. *Parker Carwash Systems Ltd.* (1977), 35 C.C.C. (2d) 37 (Ont. H.C.) the accused manager was a director of the corporation and together with his wife owned 50% of the shares and ran the day to day affairs of the corporation. The manager arranged with a company which supplied the accused corporation equipment to have the accused charged an inflated price for equipment purchased. The excess above standard cost was remitted to the manager who, without the knowledge of the Corporation's other shareholder, deposited it in a Bahamian bank account maintained by him and his wife. The full amount of the cost of the machines, however, was claimed by the accused corporation as an expense for income tax purposes. Counsel for the accused corporation argued that the corporation could not be held responsible for acts of a corporate officer which were themselves in fraud of the corporation. Hughes, J. rejected the argument and held that to the extent that the payments made to the second corporation were in excess of fair market value, the expense deducted from reported income was not reasonable and the appellant must be held to have known this and to have wilfully evaded the payment of tax otherwise exigible had the deductions not been made.

In *Rans Construction (1966) Ltd. et al.* v. *R.* unreported, May 3, 1982, Court of Queen's Bench for Saskatchewan, Judicial Centre of Saskatoon, both the corporation and its shareholders/directors were charged with tax evasion on the basis of overstating the corporation's salary expense and failing to report income received by the shareholders. Over a 4 year period, the corporation claimed certain wage expenses, and then paid these amounts, less the employee source deductions, at year end to the children or in-laws of the shareholders of the corporation. Some were employed by the corporation and some were not. The payments were called "wage adjustments". The net proceeds ultimately ended up, with some minor exceptions, in the hands of the shareholders. The Provincial Court judge rejected a number of explanations put forward by the accused to the effect that these monies were repayment of loans or payment of salaries (it was established that some of the recipients did no work for the corporation) for past services. He held that the payments constituted taxable appropriations or benefits to the principal shareholders under s. 15(1)(b) of the *ITA*. That section requires, *inter alia*, that funds of a corporation "appropriated in any manner whatever to, or for the benefit of, a shareholder", otherwise than in respect of certain matters, be included in the shareholder's taxable income.

That conclusion was upheld on appeal to the Court of Queen's Bench. It noted at 30 that the effects of the transactions carried out by the accused were two-fold:

1. The tax payable by the corporation was reduced; by claiming the wage adjustments as wage expense, it was able to reduce its profits; as well, by reducing the profit, the corporation was able to receive the benefit of the "small business deduction" which resulted in a lower rate of taxation;
2. By having the wage adjustments treated as income in the hands of the children and in-laws, the rate of taxation was lower than if the wage adjustments had been treated as income in the hands of the shareholders themselves.

Gerein, J. agreed with the Provincial Court's identification of the main issues which were firstly, whether the amounts in question charged off as wage expenses by the corporation were legitimate expenses incurred by it for the purpose of gaining or producing income for the business, and secondly, whether the shareholders of the corporation appropriated those amounts to or for their own benefit within the meaning of s. 15(1)(b) of the *ITA*. The Provincial Court judge had decided that various recipients of the wage adjustments were not legitimate employees of the corporation and were not legitimately paid the salaries which the corporation declared. That judge also found that the salaries should have been declared as income either by the corporation or by the shareholders. The failure to declare constituted evasion and the accused were convicted.

Gerein, J. characterized the issue as follows:

> . . . Put another way, if the appellants innocently or honestly thought the wage expenses were legitimate and proper they are not guilty of the offenses with which they were convicted. Rather, they would be subject to a re-assessment and the consequences that flow therefrom. However, if they dishonestly and with an ulterior motive claimed the wage expenses to evade payment of the tax they are guilty. . . [at 36-37]
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> * * *
>
> In short, the trial judge had to decide whether the so-called wages were legitimate expenses or deductions of the company and if they were not he then had to decide whether they were wilfully claimed as such to evade payment of taxes thereon. He clearly decided these questions on the basis of the relevant sections of the *Income Tax Act*. [at 44]

Gerein, J. stated that it is obvious that any employer is entitled to hire whatever employees and pay whatever remuneration. Rather:

> What the trial judge had to decide was whether the various individuals were legitimate employees of the company in the sense that they were legitimately paid the year-end adjustments. This was decided in the negative. The trial judge found that the adjustments should have been declared as income by the company or the individual appellant. This was not done and this constituted the evasion of which the appellants were convicted. [at 46]

The court also held that the remittance by the company of the employee source deductions was merely "an attempt to cloak the evasion with respectability" and "an integral part of the scheme". According to the reasons for judgment of Dube, J. in *Rans Construction (1966) Ltd. et al.* v. *Minister of National Revenue* (1987), 16 F.T.R. 73 at 74, the decision of the Court of Queen's Bench was confirmed by the Saskatchewan Court of Appeal, and leave to appeal therefrom was denied by the Supreme Court of Canada on January 25, 1983.

Many of the cases concerning the distinction between legitimate tax avoidance and illegitimate tax evasion turn on the concept of "sham".

The classic definition of "sham" is that of Diplock, L.J. in *Snook* v. *London & West Riding Investments Ltd.*, [1967] 1 All E.R. 518 at 528 (C.A.):

> I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create.

And further:

> . . .for acts or documents to be a sham, with whatever legal consequences flow from this, all the parties must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.

This definition was recently cited with approval by the Supreme Court of Canada in *Stubart Investments Ltd.* v. *R.*, 84 D.T.C. 6305 at 6320. In *Stubart*, the Minister was unsuccessful in alleging the existence of a sham in a situation involving the diversion of income to a loss company within a corporate group. The court stated:

> . . . Earlier I have enumerated the many public registrations effected by the parties in the course of this transaction. The documents establishing and executing the arrangement be tween the parties were all in the records of the parties available for examination by the authorities. There has been no suggestion of backdating or buttressing the documentation after the event. The transaction and the foreman which it was cast by the parties and their legal and accounting advisors cannot be said to have been so constructed as to create a false impression in the eyes of a third party, specifically the taxing authority. The appearance created by the documentation is precisely the realty. Obligations created in the documents were legal obligations in the sense that they were fully enforceable at law. The courts have thus far not extended the concept of sham to a transaction otherwise valid but entered into between parties not at arm's length . . . There is, in short, a total absence of the element of deceit, which is the heart and core of a sham. The parties, by their agreement, accomplish their announced purpose. The transaction was presented by the taxpayer to the tax authority but a determination of the tax consequence according to the law. I find it no basis for the application in these circumstances of the doctrine of sham as it has developed in the case law of this country.

In *R.* v. *Redpath Industries Ltd. and Dominion Sugar Co.*, *supra*, Redpath Industries incorporated a subsidiary in Bermuda, Albion Company Ltd. Albion purportedly carried on the business in Bermuda of purchasing and selling sugar, the same commodity in which Redpath dealt in Canada. Albion had no employees and its sales contracts were negotiated for it by the sales staff of Redpath. It was common ground that the arrangement was entered into to facilitate the cash needs of Redpath's parent, Tate and Lyle Ltd., a British corporation. Albion paid its profits to Redpath in the form of dividends which the latter disclosed on its tax returns as tax exempt dividends received from a foreign subsidiary. Redpath was charged with evading tax on the profits of Albion on the basis that Albion was a mere "sham" or puppet of Redpath and that Redpath should have included the raw sugar sales profits in its income for Canadian tax purposes.

Bergeron, J. emphasized the fact that Redpath had in fact declared the income in question in the form of tax exempt dividends from Albion such that there was no suppression of income from the Canadian authorities. His Lordship found that the facts did not constitute a sham as the legal rights and obligations that were created by the formation of Albion as an off-shore company were those that all parties intended to create.

In contrast to the situation in *Redpath*, the decision in *R.* v. *Myers*, 77 D.T.C. 5278 (Alta. Dist. Ct.) illustrates how a "sham" can transcend the boundaries of a civil dispute and emerge as a fraudulent act of tax evasion: Innes, *Tax Evasion in Canada*, Carswell, 1987, at 115.

The taxpayers, Myers and Inter Publishing Co. Ltd. ("Inter"), were charged with wilfully evading the payment of taxes. Myers published a newsletter offering investment advice directed mainly at the United States investors. Although Myers was aware that any company incorporated by him for the purpose of publishing his newsletter in Canada would be subject to Canadian income tax, he nevertheless caused Inter to be incorporated as a Swiss corporation. He also registered an anstalt in Liechtenstein under the name of Euro-American Publishing Establishment ("Euro"). An anstalt is a legal entity much like a corporation. Thereafter, Euro acquired ownership of the newsletter publication, and Inter became responsible for its distribution. There was a contract between Euro and Inter whereby Euro purported to transfer all its copyright and distribution rights in respect of the newsletter to Inter. The newsletter was mainly, if not entirely, the work of Myers, and the business of the newsletter was carried on in Calgary, Alberta. Following the change in ownership, the only significant change in the operation of the business was that Inter opened an office in Switzerland in which it employed a single secretary. Subscription income was deposited to a Swiss bank and expenses were paid from the Swiss office upon instructions and approval from the Calgary office. Subscription invoices were mailed from Switzerland but accounting records and all other normal business operations were conducted at Calgary, Alberta.

The share capital of Inter was issued by means of bearer shares such that the actual ownership of the company was not evident from the records. Euro, like all Liechtenstein anstalts, had no share capital. Evidence was given to the effect that the "founder" of an anstalt has virtually complete control. The official records with respect to Euro showed that the "founder" of that entity was a third party. That party could appoint and dismiss directors and wind up the anstalt at any time. The directors could delegate any of their powers. The main officers and directors of both Inter and Euro were a Swiss lawyer and the aforementioned secretary.

Myers owned both Inter and Euro. The evidence confirming his ownership consisted of his draft will in which he stated that he owned the shares of Inter and the assets of Euro, a contract in which he purported to acquire 60% interest in Euro, and secretarial notes in respect of a letter in which he disclosed that the other 40% of Euro interests were to be held in the name of two other Swiss companies in trust for himself. In addition, Inter and Euro had each executed a power of attorney under the signatures of the Swiss lawyer and secretary giving Myers the authority to act as sole representative of each entity in all matters. The Court found that it was clear beyond any doubt that Myers exercised complete control of the operations of both Euro and Inter. He was solely responsible for the publication and editorial content of the newsletter, and the Swiss secretary referred to Myers as her "boss" and sought and was given instructions from him. Myers made business deals on behalf of Euro prior to obtaining any permission from any director or official and instructed that certain property of Euro be transferred to Myers personally. In addition, Myers had control of the bank accounts of Euro and Inter in Switzerland and authorized the investment and movement of funds through these accounts as if they were his own.

During the years 1968 to 1974, Inter made substantial profits by dealing in gold and silver bullion and coins. During each of those years, Myers filed a tax return in Canada reporting his salary from Inter as income. He reported no income from Euro or any overseas investments, although he used funds from a Swiss bank account to make substantial personal acquisitions. Neither Euro nor Inter filed income tax returns in Canada for the years in question.

The court in concluding that Inter and Euro were "shams" stated at 5285 that:

> . . . The secrecy with which Myers kept the true ownership and state of affairs of Inter and Euro disguised can surely lead to no other conclusion but that he intended those entities to be used as a facade for his own business operations for the purpose of diverting his own business profits into them to avoid Canadian income tax. Nothing really changed in Myer's business dealings after Euro and Inter were set up. He conducted his business operations much the same as before except for the cover of the names of those entities.

> He continued to edit the newsletter, the newsletter kept the same format, the business operations continued to be centered in Calgary. I find that Euro and Inter were "shams" for Myers.

The court concluded that the defendant had a guilty mind and observed:

> Clearly, there is a good deal more in the actions of Myers than mere 'avoidance' of income tax. In my view the evidence establishes beyond any reasonable doubt that Myers wilfully and deliberately followed a course of conduct to conceal his true income and to deceive the income tax authorities with respect thereto. [at 5287]

There have also been many cases where the courts have been persuaded to treat one person as being an agent, puppet or nominee of another for tax purposes. Although these cases may involve a "sham" (for example, *Dominion Bridge Company* v. *The Queen* 75 D.T.C. 5150 (F.C.T.D.) and its characterization by Estey, J. in *Stubart*, *supra*), others are of the view that in recognizing the existence of an agency, the courts are simply acknowledging the legal relationship that the principal and agent have created: Arnold and Wilson, "The General Anti-Avoidance Rule — Part 1", 36 Canadian Tax Journal, 829 (1988) at 858. Where the necessary criminal intention is present, the characterization seems immaterial in point of practice.

APPENDIX 5

DUTIES OF PUBLIC AUTHORITIES

1. INTRODUCTION

My mandate requires that I consider the conduct of persons concerned with the business or affairs of the investment contract companies and their affiliates. To the extent that government regulators fall within that classification, their conduct must be scrutinized within a legal framework. The purpose of this Appendix is to outline the legal framework that guided my Investigation throughout this area, with emphasis on the standard of conduct set by law for governmental actors. The standard of conduct expected of governmental actors has been judicially articulated in administrative and constitutional law cases, as well as in actions brought by individuals seeking personal redress, e.g. damages. Whatever the occasion for applying legal standards of conduct the statute empowering or directing the governmental actor is the starting point for analysis. The statute's specific provisions empowering or requiring action are but one dimension to be considered. Equally important is the purpose of the legislative enactment.

2. PUBLIC LAW AND PRIVATE LAW

As stated in Wade, *Administrative Law* (1982, 5th ed.), public authorities often may act unlawfully yet not be liable at the suit of an injured person. For example, a licensee may have no remedy in private law where a license is wrongfully revoked. There may nonetheless be a public law remedy in the nature of a prerogative writ to prohibit, compel or quash decisions of ministers, tribunals and other statutory delegates and to otherwise compel public authorities to act lawfully in the performance of their duties. Private law remedies are founded upon a private duty owed to the injured person, a breach of that duty, and damages caused by the breach. Public law remedies are founded upon a public, usually statutory, duty.

Constitutional and administrative law are involved where public law remedies are pursued. Definitions of the 3 primary constitutional functions, namely legislative, administrative and judicial often are invoked by courts exploring the scope of the duties of public officials or tribunals. As stated by Wade, *supra* states at 44-45:

> The one distinction which would seem to be clear is that between judicial and administrative functions. A judicial decision is made according to law. An administrative decision is made according to administrative policy. . . . An administrator attempts to find what is the most expedient and desirable solution in the public interest . . . . The judge's approach is objective guided by his idea of the law. The administrator's approach is empirical, guided merely be expedience.

The learned author continues at 45:

> In 1932 the Committee on Ministers' Powers formulated contrasting definitions of judicial and quasi-judicial decisions. The important difference was that a judicial decision "disposes of the whole matter by a finding upon the facts in dispute and an application of the law of the land to the facts so found", whereas in an administrative decision this is replaced by "administrative action, the character of which is determined by the minister's free choice."

The legislative function is performed by enacting laws. Acts of the Legislative Assembly and Parliament are purely legislative. An order or decision made by a minister or other delegate pursuant to an Act may be either ministerial or a quasi-judicial, depending upon the terms of the legislation. Thus, it is important to closely examine the governing statute when considering the mandatory and discretionary powers and the duties of public officials, whether in the context of private or public law remedies.

Reid and David, *Administrative Law and Practice* (1978, 2nd ed.) state at 124-125:

> "Executive" is sometimes used as the synonym for the generic sense of "administrative", but sometimes as synonymous with its descriptive sense. "Ministerial" is sometimes used as synonymous with "administrative" in a generic sense. Since "administrative" in its generic sense is generally considered to carry the connotation "discretionary" — the existence of a wide discretion being a characteristic element in administrative power — it is disconcert ing to see the term used in a directly opposed sense, to mean mechanical; non-discretionary.

Any outline of the standards of conduct required by law in the due and proper administration of a statute draws on aspects of public and private law, and a discussion of remedies inevitably creeps in. Such remedies are not a consideration within the terms of my mandate. Remedies aside, the public and private law touching upon the conduct of government regulators in the context of the *Investment Contracts Act*, c. I-10, R.S.A. 1980 ("*ICA*") and in the context of any other applicable statute forms part of the legal framework by which I was required to be guided.

3. THE GOVERNING STATUTE — *ICA*

As outlined in detail in Chapter I when considering whether regulators are "persons concerned" within the terms of my mandate and in Chapter VIII concerning the role of the Province of Alberta, the scheme of the *ICA* is to regulate the sale of investment contracts through registration, filing and approval requirements and financial requirements such as the type of investment permitted and reserves required. Many significant aspects of the operation of an investment contract company are regulated pursuant to the terms of the *ICA*.

Selling investment contracts unless registered, using unauthorized sales material, or selling investment contracts without the required reserves or asset values on deposit are offences under s.42 of the *ICA*.

Every direction, decision, order or ruling of a Superintendent of Insurance made pursuant to the *ICA* may be appealed to a board (usually the Alberta Securities Commission) and ultimately to the Court of Appeal of Alberta.

The purpose of the legislation is to protect investment contract holders. It is consumer protection legislation.

Yuen Kun-yeu & Others v. *Attorney General of Hong Kong*, [1987] 2 All E.R. 705 (P.C.) (hereafter "*Yuen Kun-yeu*") considered whether or not depositors could bring an action in negligence against the Commissioner of Deposit-taking Companies in Hong Kong. In determining whether or not the Commissioner owed a duty to depositors that would found a remedy for the alleged failure of the Commissioner to take any action to protect depositors, Lord Keith of Kinkel stated at 712-713:

> The primary and all-important matter for consideration, then, is whether in all the circumstances of this case there existed between the commissioner and would-be depositors with the company such close and direct relations as to place the commissioner, in the exercise of his functions under the ordinance, under a duty of care towards would-be depositors. Among the circumstances of the case to be taken into account is that one of the purposes of the ordinance (though not the only one) was to make provision for the protection of persons who deposit money. . . . But the discretion given to the commissioner to register or deregister such companies, so as effectively to confer or remove the right to do business, was also an important part of the protection afforded.

Neither of the foregoing findings or the "mere" foreseeability of harm was sufficient to found the duty advocated. The court was considering whether or not a duty was owed to would-be depositors.

Some of the same elements are present in the *ICA* that were factors as in *Yuen Kun-yeu*, in terms of consumer protection legislation, foreseeability of harm and the effect of allowing registration of an investment contract company when the statute is not complied with.

Birchard et al v. *Alberta Securities Commission, Law Society of Alberta et al,* [1987] 6 W.W.R. 536 (Alta Q.B.) was an action brought by investors in a mortgage company against the ASC and the Law Society of Alberta alleging that certain lawyers who effectively owned and operated a mortgage company were neither disciplined by the Law Society of Alberta nor regulated or sanctioned by the ASC, notwithstanding that an ASC audit had uncovered irregularities in the business of the mortgage company.

The action failed because of the absence of a private law duty of care owed to the investors in the mortgage company. Agrios, J. stated at 556:

> Insofar as the *Mortgage Brokers Regulation Act* is concerned, this statute is intended to protect the borrowing public — mortgagors who purchased real estate financed by the use of mortgage loans. This is clearly not the same group as the plaintiffs, who are lending to a mortgage company. They are creditors of Battleford; they are not mortgagors. The *Deposits Regulation Act* is one of a penal nature and imposes penal sanctions to ensure statutory observation. The evidence at trial indicated this Act had been passed because of a specific problem relating to solicitations of deposits by advertising.

The learned justice went on to state that considering its purpose, the *Securities Act* did not place the plaintiffs in sufficient proximity to the ASC for a duty of care to arise. He also indicated that the facts in *Yuen Kun-yeu* seemed to him to be much more favourable to the plaintiff and that therefore the action before him must fail.

In *Anns* v. *Merton London Borough Council*, [1978] A.C. 728 (H.L.) (hereafter "*Anns*") Lord Wilberforce stated in assessing whether or not the duties of the local authority were definable in terms of private law, at 752:

> The factual relationship between . . . [the public authority] and [those members of the public affected] . . . must be considered in the relevant statutory setting . . . .

4. CHARACTERIZATION OF STATUTORY AUTHORITY

Lord Wilberforce in *Anns* drew a distinction between "duties" of a public authority and "mere powers". He stated at 754:

> Most, indeed probably all, statutes relating to public authorities and public bodies, contain in them a large area of policy. The courts call this "discretion" meaning that the decision is one for the authority or body to make, and not for the courts. Many statutes also prescribe or at least presuppose the practical execution of policy decisions: a convenient description of this is to say that in addition to the area of policy or discretion, there is an operational area. Although this distinction between the policy area and the operational area is con venient, and illuminating, it is probably a distinction of degree; many "operational" powers or duties have in them some element of "discretion". It can safely be said that the more "operational" a power or duty may be, the easier it is to superimpose upon it a common law duty of care.

"Powers" are usually delegated to officials at higher levels of authority and allow for the exercise of discretion or enable a policy choice or decision. For example, a statute with permissive language such as "the Minister may. . ." or "the Superintendent may. . ." usually allows for the exercise of discretion or for a policy decision to be made, and would generally be categorized as conferring a power.

"Duties" are usually imposed upon those at lower echelons of public authorities, at what Lord Wilberforce referred to as the "operational" level. In *Kamloops* v. *Nielsen*, [1984] 2 S.C.R. 2 (hereafter "*Kamloops*") the issue was whether or not the City of Kamloops was liable for the negligence of its building inspector in failing to enforce a building by-law and allowing the construction of a home on a hillside. The action was brought by Nielsen, a subsequent owner. The home suffered damage.

Wilson, J. said at 11:

> [When] statutes . . . [confer] powers to interfere with the rights of individuals . . . an action in respect of damage caused by the exercise of such powers will generally not lie except in the case where the local authority has done what the legislature authorized but done it negligently.

Put in another way, generally speaking in the exercise of a statutory power which is not mandatory but is rather merely empowering, there is no private law duty owed and thus no remedy for persons suffering damage as a result of the exercise of the power, provided it is exercised without negligence, reasonably, in good faith, on the basis of relevant considerations and unfettered.

5. THE EXERCISE OF DISCRETION

Lord Diplock described the discretion exercised by public authorities in *Secretary of State for Education and Science* v. *Tameside Metro Borough Council*, [1977] A.C. 1014 (H.L.) at 1064 as follows:

> The very concept of administrative discretion involves a right to choose between more than one possible course of action upon which there is room for reasonable people to hold differing opinions as to which is to be preferred.

Such discretion is not plenary. The rule of law constrains the exercise of discretion by public authorities. The classic statement on the point is by Lord Halsbury in *Sharp* v. *Wakefield*, [1891] A.C. 173 (H.L.) as follows at 179:

> "Discretion" means when it is said that something is to be done within the discretion of the authorities that that something is to be done according to the rules of reason and justice, not according to private opinion: *Rooke's Case*; according to law, and not humour. It is to be, not arbitrary, vague, and fanciful, but legal and regular. And it must be exercised within the limit to which an honest man competent to the discharge of his office ought to confine himself.

In another leading case, *Westminster Corporation* v. *London and North Western Railway*, [1905] A.C. 426 (H.L.), Lord Macnaghten said at 430:

> A public body invested with statutory powers such as those conferred upon the Corporation must take care not to exceed or abuse its powers. It must keep within the limits of the authority committed to it. It must act in good faith. And it must act reasonably.

In *Roberts* v. *Hopwood*, [1925] A.C. 578 (H.L.) Lord Wrenbury stated at 613:

> A person in whom is vested a discretion must exercise his discretion upon reasonable grounds. A discretion does not empower a man to do what he likes merely because he is minded to do so — he must in the exercise of his discretion do not what he likes but what he ought. In other words, he must, by use of his reason, ascertain and follow the course which reason directs. He must act reasonably.

Finally, in *Associated Provincial Picture Houses Ltd.* v. *Wednesbury Corporation*, [1947] 2 All E.R. 680 (C.A.) Lord Greene, M.R. in considering the scope of matters a licencing authority could consider in exercising its discretion held at 682 that:

> The law recognizes certain principles on which the discretion must be exercised, ... What, then, are those principles? They are perfectly well understood. The exercise of such a discretion must be a real exercise of the discretion. If, in the statute conferring the discretion, there is to be found, expressly or by implication, matters to which the authority exercising the discretion ought to have regard, then, in exercising the discretion, they must have regard to those matters. Conversely, if the nature of the subject matter and the general interpretation of the Act make it clear that certain matters would not be germane to the

> matter in question, they must disregard those matters. Expressions have been used in cases where the powers of local authorities came to be considered relating to the sort of thing that may give rise to interference by the court. Bad faith, dishonesty — those, of course, stand by themselves — unreasonableness, attention given to extraneous circumstances, disregard of public policy, and things like that have all been referred to as being matters which are relevant for consideration.

From all of the foregoing statements, it may be seen that public authorities abuse their discretion where they: act for improper purposes or in bad faith; act unreasonably; act on the basis of irrelevant considerations; or, fail to act at all or fetter their discretion by adopting an inflexible policy. Each of these will be addressed in turn.

(a) Duty to Act for Proper Purposes and in Good Faith

In exercising discretion public authorities must act in accordance with the purpose of the empowering statute and not for any unauthorized purpose.

In the leading case of *Padfield* v. *Minister of Agriculture, Fisheries and Food*, [1968] 1 All E.R. 694 (H.L.) Lord Reid said at 699:

> Parliament must have conferred the discretion with the intention that it should be used to promote the policy and objects of the Act; the policy and objects of the Act must be determined by construing the Act as a whole and construction is always a matter of law for the court. In a matter of this kind it is not possible to draw a hard and fast line, but if the Minister, by reason of his having misconstrued the Act or for any reason, so uses his discretion as to thwart or run counter to the policy and objects of the Act, then our law would be very defective if persons aggrieved were not entitled to the protection of the court.

In *Roncarelli* v. *Duplessis*, [1959] S.C.R. 121 Rand, J. said at 140:

> In public regulation of this sort there is no such thing as absolute and untrammelled "discretion", that is that action can be taken on any ground or for any reason that can be suggested to the mind of the administrator; no legislative Act can, without express language, be taken to contemplate an unlimited arbitrary power exercisable for any purpose, however capricious or irrelevant, regardless of the nature or purpose of the statute. Fraud and corruption in the Commission may not be mentioned in such statutes but they are always implied as exceptions. "Discretion" necessarily implies good faith in discharging public duty; there is always a perspective within which a statute is intended to operate; and any clear departure from its lines or objects is just as objectionable as fraud or corruption.

It is generally accepted that discretion must be exercised in good faith; bad faith renders any exercise of discretion improper. However, "bad faith" has a very broad meaning in relation to discretion. As Wade, *supra*, states at 391:

> The judgments discussed in the last few pages are freely embellished with references to good and bad faith. These add very little to the true sense, and are hardly ever used to mean more than that some action is found to have a lawful or unlawful purpose. It is extremely rare for public authorities to be found guilty of intentional dishonesty: normally they are found to have erred, if at all, by ignorance or misunderstanding. Yet the courts constantly accuse them of bad faith merely because they acted unreasonably or on improper grounds. Again and again it is laid down that powers must be exercised reasonably and in good faith. But in this context "in good faith" means merely "for legitimate reasons". Contrary to the natural sense of the words, they impute no moral obliquity.

Rand, J. made it abundantly clear in *Roncarelli*, *supra* that "good faith" is inextricably bound up with properly carrying out the purpose of the legislation which confers the discretion. He stated at 140:

> "Good faith" in this context, applicable both to the respondent and the general manager, means carrying out the statute according to its intent and for its purpose; it means good faith in acting with a rational appreciation of that intent and purpose and not with an improper intent and for an alien purpose; it does not mean for the purposes of punishing a person for exercising an unchallengeable right; it does not mean arbitrarily and illegally attempting to divest a citizen of an incident of his civil status.

The concept is explored further by *Wade*, *supra*, at 392-3:

> The courts no less frequently use the words "good faith" in their ordinary sense, implying personal honesty and good intentions. In the licensing cases where the authorities wrongly demanded a money payment or the buying-in of suspended licences, the court in each case emphasised that the unlawful conditions were imposed in perfectly good faith, i.e. in what was genuinely thought to be in the public interest. The same words were freely used in both senses in a decision condemning a district council's compulsory purchase order for land allegedly required for coast protection: at first instance the order was held to be "an abuse of power and a flagrant invasion of private rights which the council has tried to cover up by means which do them no credit". But the Court of Appeal decided that it was not necessary to go so far as to hold the council "guilty of bad faith". Elsewhere in this case "mala fide" was used merely to mean "for an unauthorized purpose". Such opprobrious terms would be more suitably restricted to the rare cases of actual dishonesty, as Megaw L.J. has advocated. [In *Cannock Case D.C.* v. *Kelly*, [1978] 1 W.L.R. 755 at 777]
>
> > I would stress — for it seems to me that an unfortunate tendency has developed of looseness of language in this respect — that bad faith, or, as it is sometimes put, "lack of good faith", means dishonesty: not necessarily for a financial motive, but still dishonesty. It always involves a grave charge. It must not be a treated as a synonym for an honest, though mistaken, taking into consideration of a factor which is in law irrelevant.
>
> It is a pity that this good advice is not more generally accepted.

(b) Duty to Act Reasonably

Statutory delegates must discharge their duties and exercise their powers reasonably. What is "reasonable" depends upon the facts of each case. As Lord Diplock stated in *Tameside*, *supra*, at 1064:

> My Lords, in public law "unreasonable" as descriptive of the way in which a public authority has purported to exercise a discretion vested in it by statute has become a term of legal art. To fall within this expression it must be conduct which no sensible authority acting with due appreciation of its responsibilities would have decided to adopt.

In *Wednesbury*, *supra*, Lord Greene, M.R. considered the duty to act reasonably in the following terms at 683:

> In the present case we have heard a great deal about the meaning of the word "unreasonable". It is true that discretion must be exercised reasonably. What does that mean? Lawyers familiar with the phraseology commonly used in relation to the exercise of statutory discretions often use the word "unreasonable" in a rather comprehensive sense. It is frequently used as a general description of the things that must not be done. For instance, a person entrusted with a discretion must direct himself properly in law. He must call his own attention to the matters which he is bound to consider. He must exclude from his consideration matters which are irrelevant to the matter that he has to consider. If he does not obey these rules, he may truly be said, and often is said, to be acting "unreasonably". Similarly, you may have something so absurd that no sensible person could ever dream that it lay within the powers of the authority.

In assessing "reasonable" J.H. Grey, "Discretion in Administrative Law" (1979), 17 Osgoode Hall, L.J. 107 states at 118:

> One of the criteria the courts may use is whether reasonableness is prescribed by statute, and if so, how the statute is phrased and what are its purposes. But, it is submitted, the presence of a duty to act reasonably need not be specified; it is always presumed.

The *Tameside* decision represents a significant development. There the Secretary of State was given a broad statutory discretion to overrule an elected local council if he was "satisfied. . . that any local education authority. . . have acted or are proposing to act unreasonably." The Secretary of State, who was a member of the Labour Party, used his discretion under the statute to stop the implementation of the policies of a rival Conservative Party local authority. The House of Lords explicitly found that the Secretary of State acted in good faith, and that he did not misdirect himself or consider irrelevant matters. Nevertheless, his decision was found to be improper and was quashed. The court found that in all of the circumstances of the case the decision of the Secretary of State was so unreasonable that even without an explicit error the exercise of discretion was such that no reasonable person could make it.

(c) The Duty Not to be Influenced by Irrelevant Considerations

The exercise of discretion is not to be influenced by irrelevant considerations.

The exercise of discretion by a statutory delegate was considered in *City of Prince George* v. *Payne*, [1978] 1 S.C.R. 458. A city council denied an applicant a business licence in order to protect the community's moral welfare. The British Columbia Court of Appeal decision that the council had no authority when exercising its discretion to take into account irrelevant considerations was upheld on appeal.

In *Smith and Rhuland Ltd.* v. *The Queen*, [1953] 2 S.C.R. 95 a union was refused certification because its secretary-treasurer was a communist. Rand, J. stated as follows at 100:

> I am unable to agree, then, that the Board has the power to act upon the view that official association with an individual holding political views considered to be dangerous by the Board proscribes a labour organization. Regardless of the strength and character of the influence of such a person, there must be some evidence that, with the acquiescence of the members, it has been directed to ends destructive of the legitimate purposes of the union, before that association can justify the exclusion of employees from the rights and privileges of a statute designed primarily for their benefit.

In *Re Multi-Malls Inc.* v. *Minister of Transport*, [1976] 14 O.R. (2d) 49 (C.A.) Lacourciere, J.A. stated at 62:

> I am of the opinion that the Minister of Transportation and Communications allowed himself to be influenced by extraneous, irrelevant and collateral considerations which should not have influenced him in the exercise of his discretion to refuse the entrance permit. It seems clear that the purpose of the Act in general is not to ensure proper land use planning but generally to control traffic.

What considerations are irrelevant will depend upon the circumstances of each case. Statutory provisions and other factors are considered, although the weight to be given to other factors varies with each fact situation. For example, *Aluminum Co. of Canada* v. *R* (1986), 19 Admin. L.R. 192 (Ont. Div. Ct.) held that in enacting regulations under the *Environmental Protection Act* to postpone the introduction of aluminum beverage containers, the Lieutenant Governor in Council was entitled to take into consideration an ailing competing sector of the economy that would be affected by the decision.

(d) Duty to Act and Not to Fetter Discretion

A statutory delegate of discretionary powers is required to give due consideration before taking a decision not to act at all.

The failure to undertake any action at all was considered by Wilson J. in *Kamloops*. She applied the reasoning of Lord Wilberforce in *Anns* as follows at 10:

> [Lord Wilberforce] then dealt with the argument that where the local authority is under no duty to inspect but merely has a power to inspect, it can avoid liability for negligent inspection by simply deciding not to inspect at all. [Lord Wilberforce] pointed out that this overlooks the fact that local authorities are public bodies operating under statute with a clear responsibility for public health in their area. They must, therefore, make their discretionary decisions responsibly and for reasons that accord with the statutory purpose. They must at the very least give due consideration to the question whether they should inspect or not and, having decided to inspect, they must then be under a duty to exercise reasonable care in conducting that inspection.

A statutory official must not refuse to exercise discretion and must not fetter discretion but what of a failure to exercise a discretion as a result of a policy articulated by some other governmental body? Jones and de Villars, *Principles of Administrative Law* (1985) state that it is improper for a statutory delegate to fetter discretion by adhering to a governmental policy that is irrelevant or improper. If the statutory delegate does exercise discretion by reference to an irrelevant or improper policy, the exercise of the power is tainted. Jones and de Villars continue at 141 as follows:

> On the other hand, even if the external policy is relevant, the rule against fettering requires the delegate to exercise his own discretion in deciding whether and how to accept the policy. In particular, the delegate cannot simply treat the external policy as a given, and may be required to permit cross examination and refutation of that policy.

Therefore a governmental policy that is irrelevant is not a factor which a statutory delegate may consider. If, however, the governmental policy is relevant the statutory delegate may address the policy but must not allow the policy to fetter the exercise of discretion. In fact discretion must be exercised.

In *Wimpey Western Ltd. et al.* v. *Director of Standards et al.* (1983), 28 Alta. L.R. (2d) 193 (C.A.) the appellants applied to the respondent director for a permit to construct a waste water treatment facility for an industrial park. The director refused the permit, preferring to defer such treatment facilities until a proposed regional sewage plant was operational, in keeping with a minister's policy. The appellants argued that the director improperly exercised his discretion by taking into account the irrelevant consideration of the minister's policy and by fettering his discretion in adhering to the minister's policy.

Upon considering the relevant statutory provisions and all of the facts of the case it was concluded that the director was not restricted solely to considerations of whether the facility heeded technical standards established by the Act. Rather, the director properly gave consideration to the minister's policy as the policy was relevant to preventing pollution and maintaining the quality of water. In fact, the intent and purpose of the relevant statute giving the director power was to provide effective means of preventing pollution and maintaining the quality of water. Therefore, the government policy was relevant and was properly considered by the director in exercising his discretion. Harradence, J.A. stated at 201:

> The factors which are relevant need not be limited to those implicit in the enabling Act. The test is whether the consideration in question is within the intent and purpose of the Act.

It is clear that like other considerations facing a statutory delegate when exercising discretion, governmental policies and their effect on discretion are dependent on the circumstances of each case and their relevance to the particular statutory framework. These principles are summarized by de Smith, *Judicial Review of Administrative Actions*, (1980, 4th ed.), wherein the learned author states at 340-341:

> In determining what factors may or must be taken into account by the competent authority, the courts are faced with problems of statutory interpretation. . . . If relevant factors are specified in the enabling Act it is for the courts to determine whether they are factors to which the authority is compelled to have regard and, if so, whether they are to be construed as being exhaustive. If the relevant factors are not specified . . . it is for the courts to determine whether the permissible considerations are impliedly restricted, and if so, to what extent. . . .

In summary, a statutory delegate in exercising a power must:

1 Exercise it in a manner consistent with the purposes of the empowering statute and in good faith;

2 Exercise it in a reasonable manner and arrive at a reasonable result;

3 Exercise it, meaning that considering the issue cannot be avoided even if the result is a decision not to act;

4 Not fetter discretion by adopting inflexible policies for any situation, when required to come to a decision on the facts;

5 Not take into account irrelevant considerations.

Where these guidelines are followed, the statutory duty has been properly discharged and the decision cannot be questioned. This is so even where, in retrospect, it is obvious that the delegate has come to an incorrect decision. The delegate has the right to be wrong so long as the discretion is properly exercised. These guidelines taken together constitute a standard of conduct for statutory delegates in the exchange of their duties. The standard is not affected by the unavailability of a private law remedy in the case of failure to conform to the standard.

6. OPERATIONAL DUTIES — PRIVATE LAW

The law relating to operational duties is outlined in *Kamloops* by Wilson, J. who said at 11 as follows:

> . . . then the policy decision having been made there is a duty at the operational level to use due care in giving effect to it.

In *Anns* the public authority was obligated to exercise a *bona fide* discretion as to whether or not to inspect the foundations of a building. Once the authority decided to inspect the building foundations, then the inspector and others at the operational level were bound to exercise reasonable skill and care in doing so. The failure to exercise reasonable skill and care directly affected the owner and occupants of the house and a private law duty of care was found at the operational level. Lord Wilberforce stated at 758 with respect to the existence of a private law duty of care that:

> There is, in my opinion, no difficulty about this. A reasonable man in the position of the inspector must realize that if the foundations are covered in without adequate depth or strength as required by the by-laws, injury to safety or health may be suffered by owners or occupants. The duty is owed to them . . . .

It is evident that the closer the impugned activity is to the operational level the more likely it is there is the requisite "proximity" to found a duty of care as between the public authority and the individual affected by the actions of the public authority.

Any common law immunity of the Government of Alberta from private suits is abrogated by the *Proceedings Against The Crown Act*, R.S.A. 1980, c. P-18, pursuant to which operational activity involving government employees, Crown servants and agents may found liability in tort, like the activity of any other individual.

After the initial development of the "two stage" private law duty test in *Anns*, there followed a gradual refinement of the law. There is now an expanding body of authority covering the factors to be considered before attaching tortious liability to government activity. In *Yuen Kun-yeu* Lord Keith observed at 712:

> The second stage of Lord Wilberforce's test is one which will rarely have to be applied. It can arise only in a limited category of cases where, notwithstanding that a case of negligence is made out on the proximity basis, public policy requires that there should be no liability. . . .
>
> In view of the direction in which the law has since been developing, their Lordships consider that for the future it should be recognized that the two-stage test in *Anns* is not to be regarded as in all circumstances a suitable guide to the existence of a duty of care.
>
> The primary and all-important matter for consideration, then, is whether in all the circumstances of this case there existed between the commissioner and would-be depositors with the company such close and direct relations as to place the commissioner, in the exercise of his functions under the ordinance, under a duty of care towards would be depositors.

The court in *Yuen Kun-yeu* reviewed in great detail the statutory framework that the Commissioner of deposit taking companies worked within. The Commissioner had the power to prohibit the carrying on of business. The deposit taking companies themselves had many obligations under the Act including, *inter alia* to exhibit accounts at each place of business; to notify the Commissioner of changes in the company; to report to the Commissioner if the company would be unable to meet its obligations; to submit monthly returns to the Commissioner showing its assets and liabilities; to maintain certain reserves; to restrain or limit advances to certain parties; and to maintain at all times holdings in certain specified liquid assets.

Lord Keith said that the Commissioner had no power to control the day-to-day activities of those who caused the loss and damage. He could only stop the company carrying on business, and such a decision was well within the discretionary sphere of his functions. The fact that the Commissioner may have had cogent reason to suspect that the company's business was being carried on improperly did not create a special relationship between the company and the Commissioner. The comments at 713 make it clear that where the policy/operational demarcation line is blurred in enabling legislation common sense must be used to determine if a private law duty of care exists:

> No doubt it was reasonably foreseeable by the commissioner that, if an uncreditworthy company were placed on or allowed to remain on the register, persons who might in the future deposit money with it would be at risk of losing that money. But mere foreseeability of harm does not create a duty, and future would-be depositors cannot be regarded as the only persons whom the commissioner should properly have in contemplation. In considering the question of removal from the register, the immediate and probably disastrous effect on existing depositors would be a very relevant factor. It might be a very delicate choice whether the best course was to deregister a company forthwith or to allow it to continue in business with some hope that, after appropriate measures by the management, its financial position would improve. It must not be overlooked that the power to refuse registration, and to revoke or suspend it, is quasi-judicial in character, as is demonstrated by the right of appeal to the Governor in Council conferred on companies by s. 34 of the ordinance, and the right to be heard by the commissioner conferred by s. 47. The commissioner did not have any power to control the day-to-day management of any company, and such a task would require immense resources. His power was limited to putting it out of business or allowing it to continue. No doubt recognition by the company that the commissioner had power to put it out of business would be a powerful incentive impelling the company

> to carry on its affairs in a responsible manner, but if those in charge were determined on fraud it is doubtful if any supervision could be close enough to prevent it in time to forestall loss to depositors. In these circumstances their Lordships are unable to discern any intention on the part of the legislature that in considering whether to register or deregister a company the commissioner should owe any statutory duty to potential depositors. It would be strange that a common law duty of care should be superimposed on such a statutory framework.

He continued at 714:

> . . . In the present case there was clearly no voluntary assumption by the commissioner of any responsibility towards the appellants in relation to the affairs of the company. It was argued, however, that the effect of the ordinance was to place such a responsibility on him. Their Lordships consider that the ordinance placed a duty on the commissioner to supervise deposit-taking companies in the general public interest, but no special responsibility towards individual members of the public. His position is analogous to that of a police force, which in *Hill* v. *Chief Constable of West Yorkshire* [1987] 1 All E.R. 1173, [1987] 2 W.L.R. 1126 was held to owe no duty towards individual potential victims of crime. The ordinance was designed to give added protection to the public against unscrupulous or improvident managers of deposit-taking companies, but it cannot reasonably be regarded, nor should it have been by any investor, as having instituted such a far-reaching and stringent system of supervision as to warrant an assumption that all deposit-taking companies were sound and fully creditworthy. While the investing public might reasonably feel some confidence that the provisions of the ordinance as a whole went a long way to protect their interests, reliance on the fact of registration as a guarantee of the soundness of a particular company would be neither reasonable nor justifiable, nor should the commissioner reasonably be expected to know of such reliance, if it existed. Accordingly their Lordships are unable to accept the appellants' arguments about reliance as apt, in all the circumstances, to establish a special relationship between them and the commissioner such as to give rise to a duty of care.

Thus, the cases show that all of the circumstances of the particular case must be considered, not only the foreseeability of harm, but also the statutory framework involved, the relationship and history of dealings between the parties, and other policy and common sense considerations.

In the context of the *ICA*, many investors or would-be investors may have been entitled to rely on the fact of registration, or the fact that the investment contract companies were granted permission to sell and continued to sell investment contracts. In the result, then, they may have been entitled to rely on continued registration as reasonable assurance of financial soundness, if not a guarantee. It is both reasonable and justifiable that such reliance be placed in light of the governing statutory provisions.

In short, a private law duty may very well be owed by the persons responsible for the due administration of the *ICA* to investment contract purchasers. Whether or not a private law remedy is available to investors is not within the scope of my mandate, but in any case that does not affect the legal formulation of the standard of conduct.

Care must be taken to emphasize that in the context of my mandate I am formulating and identifying a legal framework against which the conduct of regulators is to be measured not formulating or identifying a legal basis for liability of government regulators to private individuals. In many of the cases where a duty of care was found to exist, the court found that in private law no remedy was available for the breach of that duty. The distinction ought not to be blurred.

7. DUTY TO LEGISLATE

The statutory framework in which public authorities exercise their powers and carry out their duties is a crucial consideration in formulating a standard of conduct required of them, as stated above.

With respect to the ICA an issue was raised regarding the duty, if any, of the Government of Alberta to amend the ICA or pass replacement legislation as a means of more effectively regulating FIC and AIC.

The issue of whether there is a private law duty of care to legislate has been judicially considered on several occasions. In *Welbridge Holdings Ltd.* v. *Metropolitan Corporation of Greater Winnipeg*, [1971] S.C.R. 957 the respondent public authority had control of zoning in the City of Winnipeg, and in the course of carrying out its duties exercised a legislative function in passing certain by-laws. The public authority improperly passed a zoning by-law which the appellant relied upon as valid. The appellant proceeded to develop a housing project in reliance upon the by-law and on the footing that it had proper zoning approval. Subsequently, when the by-law was declared void, the appellant lost a substantial investment in the development and brought an action against the public authority seeking to fix the public authority with a breach of a private law duty of care to have properly exercised its legislative function. Laskin, J. as he then was, in delivering the judgment of the court made it clear that no private law duty of care existed when the public authority in question exercised a legislative function. He stated at 967:

> A rezoning application merely invokes the defendant's legislative authority and does not bring the applicant in respect of his particular interest into any private nexus with the defendant, whose concern is a public one in respect of the matter brought before it. The applicant in such case can reasonably expect honesty from the defendant but not a wider duty.

He concluded with respect to legislative powers generally at 970:

> . . . the risk of loss from the exercise of legislative or adjudicative authority is a general public risk and not one for which compensation can be supported on the basis of a private duty of care. The situation is different where a claim for damages for negligence is based on acts done in pursuance or in implementation of legislation or of adjudicative decrees.

In *Kwong* v. *Alberta et al.*, [1979] 2 W.W.R. 1 (Alta. C.A.) Kwong died as a result of carbon monoxide poisoning after his furnace had been improperly connected in a conversion from oil to gas. The conversion was approved by a provincial government gas inspector whose job it was to make inspections pursuant to regulations passed under the *Gas Protection Act*. At trial, liability in negligence was found against the provincial government on the ground that the Gas Protection Branch was entrusted very broad control and ought to have warned furnace users of certain inherent dangers related to furnaces.

On appeal, counsel for Kwong argued for a duty to pass legislation relating to warnings for the protection of the public. This argument was later abandoned, but Chief Justice McGillivray stated clearly at 8 in allowing the appeal:

> If the basis of the judgment of the learned trial judge was that the Lieutenant-Governor in Council should have caused regulations having the force of law to be enacted and that for not doing so the Crown is liable, in my view the Learned Trial Judge erred in law.

He continued at 9:

> Clearly, there can be no cause of action for the failure of ministers of the Crown to cause to be enacted specific regulations or enactments.

Finally, in *Mahoney* v. *Government of Canada* (1986), 4 F.T.R. 259 (F.C.T.D.) an infant was asphyxiated when he became wedged between the mattress and the frame of his crib. His parents brought an action for damages against the federal government claiming, *inter alia*, that the government and in particular the Department of Consumer and Corporate Affairs, failed to adequately regulate cribs under the *Hazardous Products Act* and failed to legislate any regulations dealing with the hooks in the crib that caused the infant's death thereby failing to exercise its duty and live up to its mandate to promote health and safety to the public. The parents' position was that the Crown ought to be liable directly in tort to a private citizen for failure to properly legislate.

Cullen, J. in striking the plaintiff's claim referred to both *Welbridge Holdings* and *Kwong* and stated at 263:

> The law is quite clear. As counsel for the applicant states, "The Alberta Court of Appeal and the Supreme Court of Canada have said that the 'Failure to pass regulations having the force of law cannot be the subject of action' and 'it is not open to the Court to say that there should be regulations'".

He concluded at 265:

> It seems quite clear that the plaintiffs have no cause of action against the Crown in the circumstances of this case. . . .
>
> When government acts in its "operations sphere" (an inspector not doing his job or doing it negligently) then a case against the Crown can be made. That is not the case here.

In summary, it is settled law that governments or the Crown do not have a private law duty of care to pass legislation.

8. CONCLUSIONS

The following conclusions may be drawn from the above analysis with respect to the duties and obligations of public authorities:

1. Provisions of statutes may give the public authority "powers" or "duties" and usually provide for a combination of both.
2. Generally, statutory "powers" are given to higher public officials and allow for the exercise of discretion or policy choices. In a factual situation involving the delegation of discretionary powers to a public authority, the statutory official in exercising a discretion or power must:
    - (a) Exercise discretion in a manner consistent with the purposes and objects of the empowering legislation;
    - (b) Act in good faith and for an authorized purpose;
    - (c) Exercise discretion in a reasonable manner and arrive at a reasonable result;
    - (d) Exercise the discretion, meaning that considering the issue cannot be avoided even if the result is a decision not to act;
    - (e) Not fetter discretion by adopting inflexible policies for any situation, when required to come to a decision on the facts;
    - (f) Not take into account irrelevant considerations.
3. Generally, statutory "duties" (or "operational duties") are given to those at the lower echelons of the public authority ("the operational level"). Operational duties are usually exercised in a setting where there is a direct relationship or contact with the individual being affected by the actions of the public authority and are analogous to private law relationships. In pure operational settings the test for finding a private law duty of care in essence becomes the private law "neighborhood" test, limited only by policy considerations as outlined in the second part of a two-stage test for determining liability of public authorities.
4. Most enabling statutory provisions include elements of both "powers" and "duties" and in such cases the two-stage test should be applied to determine if a private law duty of care arises. The two-stage test has been refined and recent case authorities suggest that application of the test should involve the following process:

(a) consideration of all relevant circumstances and factors involved in the particular case including indicia of proximity in the first stage and public policy considerations in the second stage; and

(b) an application of common sense in arriving at a decision.

5. From an analysis of the relevant cases the factors or circumstances which have been considered significant by courts in determining whether there is a private law duty of care are as follows:

   (a) If the purpose of the statute governing the actions of the public authority is for the protection of the public by the public authority there is a greater likelihood of a private law duty of care existing;

   (b) If the function of the public authority relates to public safety and health there is a greater likelihood of a private law duty of care existing;

   (c) If the actions of the public authority further the purposes of the legislation or statute it operates under there is a greater likelihood of a private law duty of care existing;

   (d) If the public authority has knowledge that individuals are relying upon it to perform certain actions then the greater the degree of reliance the greater the likelihood of a private law duty of care existing;

   (e) If the individual or individuals affected by the actions of the public authority have remedies apart from a civil negligence action (such as the use of prerogative writs or a contract remedy) there will be less likelihood of a private law duty of care existing; and

   (f) If there are other public policy matters that weigh against the finding of a private law duty of care then there will be less likelihood of a private law duty of care existing.

6. Applying the above general principles with "common sense" and a full analysis of all relevant facts and circumstances, one should reasonably be able to determine the duties and obligations at law of public authorities.

7. A Government or Minister of the Crown has no private law duty of care to pass legislation having the force of law.

8. Care must be taken to recognize that the term "private law duties" not only encompasses the standard of care to be observed by public official but also denotes that a breach of that standard affords a remedy to an aggrieved or injured individual. Thus, the fact that there exists no private law duty does not mean that there exists no standard of conduct by which public officials ought to govern themselves. Public law or administrative law remedies such as orders in the nature of the prerogative writs as discussed earlier are only available in the event of a failure to comply with a prescribed standard of conduct.

SCHEDULE A

COURT ORDERS PERTAINING TO THE CONDUCT OF THE INVESTIGATION AND PUBLIC HEARINGS

Date	*Substance of Order*
July 29, 1987	Order of Justice Berger amending Orders of Justice Wachowich directing the appointment of an Inspector, setting out his duties, directing the appointment and duties of Special Counsel for investment contract holders and ordered the reasonable costs of the Inspector, the Investment Contract Holders Committee and Special Counsel for the investment contract holders be paid by the Provincial Treasurer.
August 13, 1987	Order of Justice Berger allowing Inspector to conduct hearings with the power to summon and compel attendance of witnesses, including Ministers of the Crown, in Right of the Province of Alberta and their deputies and employees and to seek document production and appointing William E. Code, Q.C. as Inspector.
September 18, 1987	Order of Justice Berger appointing Robert B. White, Q.C. of Edmonton, Alberta and John G. McNiven of Calgary, Alberta as Special Counsel for the investment contract holders.
November 2, 1987	Order of Justice Berger directing the Royal Bank of Canada to permit the Inspector or his selected legal staff to inspect the records of and to take copies of any books, records and documents in the possession of the Royal Bank of Canada pertaining to the assets held on deposit by the Royal Bank of Canada on behalf of FIC pursuant to Section 8(c) of the *ICA*.
November 2, 1987	Order of Justice Berger directing the Canadian Imperial Bank of Commerce to permit the Inspector or his selected legal staff to inspect the records of and to take copies of any books, records and documents in the possession of the Canadian Imperial Bank of Commerce pertaining to the assets held on deposit by the Canadian Imperial Bank of Commerce on behalf of FIC pursuant to Section 8(c) of the *ICA*.
November 2, 1987	Order of Justice Berger authorizing Robert B. White, Q.C. and John G. McNiven as Special Counsel for the investment contract holders to retain chartered accountants to assist in representing the relevant concerns of investment contract holders and directing the Provincial Treasurer of the Province of Alberta to pay the reasonable costs thereof.
November 12, 1987	Order of Justice Berger refusing the application of the Trustee in Bankruptcy of PGL to amend the mandate of the Inspector so as to inquire into the reasons for the financial failure of PGL and other affiliates of FIC and AIC. (*Re Associated Investors of Canada Ltd. and First Investors Corporation Ltd.* (1988), 56 Alta. L.R. (2d) 111)
November 19, 1987	Order of Justice Berger directing Touche Ross and Co. to produce to the Inspector or his staff, including partners and employees of Clarkson Gordon, their audit files for the years 1982 and 1983 relating to the audit of Principal Group.
December 3, 1987	Order of Justice Berger directing that Deloitte Haskins & Sells produce to the Inspector and his counsel and staff all final drafts of PGL's 1986 financial statements.

December 15, 1987	Order of Justice Berger authorizing the Inspector to conduct any portion of the hearing *in camera* and seal any exhibit from public view where the Inspector is satisfied that the disclosure of such information would, in the opinion of the Inspector, prejudice the affairs of Coopers & Lybrand Limited as Manager of FIC and AIC, B.I. Robertson & Associates as the Provisional Liquidator of PS&T or Collins Barrow Limited as Trustee in Bankruptcy of PGL.
December 16, 1987	Order of Justice Berger directing CDIC to produce all books, documents, records, correspondence and memoranda relating to PS&T, FIC and AIC and any of their affiliates subject to public interest immunity claims. (*Re Associated Investors of Canada Ltd.; Re First Investors Corporation Ltd.* (1988), 57 Alta. L.R. (2d) 71)
February 8, 1988	Order of Justice Berger extending the date for completion of the final Report to within 10 months from August 13, 1987.
February 17, 1988	Order of the Court of Appeal setting aside the Order of Justice Berger regarding production of CDIC documents made December 16, 1987 and ordered that a *subpoena* or *subpoena duces tecum* against the appropriate officer or officers of CDIC be issued to require an appearance before the Inspector with relevant documents. (*Re Associated Investors of Canada Ltd.; Re First Investors Corporation Ltd.; Canada Deposit Insurance Corporation* v. *Inspector* (1988), 57 Alta. L.R. (2d) 289.)
March 18, 1988	Order of Justice Berger directing the production of documents by Donald M. Cormie with the exception of an orange binder and pertaining to CIL and EL&F. (*Re First Investors Corporation Ltd. (#2)* (1988), 87 A.R. 279.)
March 18, 1988	Order of Justice Berger directing the Inspector not to report his opinion on whether any individual, corporation or government agency has committed fraud or any other illegal act or is liable for acts of negligence, wrongdoing or illegality and directing the Inspector to report to the court whether he has discovered evidence tending to show those matters enumerated in subsections 223(2)(a) to (d) of the *BCA* and in doing so to consider and apply existing law, set out his findings of fact and the evidence in support thereof and delineate and report to the court the legal framework that guided the investigation. (*Re First Investors Corporation Ltd.; Re Associated Investors of Canada Ltd.* (1988), 58 Alta. L.R. (2d) 38; 86 A.R. 126)
May 27, 1988	Order of Justice Berger extending the time for filing the final report of the Inspector to within 13 months from August 13, 1987.
June 1, 1988	Order of Justice Berger refusing the Inspector's application for a direction that no witness is entitled to refuse to answer a question put to him in circumstances where the Inspector has ruled thereon and directed the witness to answer.
June 3, 1988	Order of the Court of Appeal with respect to the scope of the Inspector's mandate, affirming the Order of Justice Berger March 18, 1988, subject only to directing the Inspector to report as to whether he has discovered evidence both tending to prove and tending to disprove the enumerated matters in Section 223(2)(a) to (d) of the *BCA*. (*Re Associated Investors of Canada Ltd.; Re First Investors Corporation Ltd.* (1988), 59 Alta. L.R. (2d) 334; 87 A.R. 273)

August 30, 1988	Order of Justice Berger extending the time for filing the final Report to within 60 days from the date upon which receipt of reply arguments of counsel are due.
September 15, 1988	Order of Justice Berger refusing an application by Special Counsel for the investment contract holders, John G. McNiven, to investigate the business and affairs of FIC and AIC and their affiliates in the provinces of Saskatchewan, New Brunswick, Prince Edward Island, Nova Scotia and Newfoundland, and in particular, the governmental regulatory authorities of those provinces.
September 15, 1988	Order of Justice Berger refusing an application by the Inspector for the issuance of *subpoenae duces tecum* compelling the attendance of British Columbia regulatory authorities pursuant to the *Interprovincial Subpoena Act*, S.A. 1981 c. I-8.1. (*Re Associated Investors of Canada Ltd.; Re First Investors Corporation Ltd.* (1988), 61 Alta. L.R. (2d) 360; 93 A.R. 354)
October 13, 1988	Order of Justice Berger refusing the application of Donald M. Cormie to compel the Government of Alberta to produce all documents relating to the reasons for the failure of Alberta based financial institutions between 1981 and 1987, and the policies and treatment by the Government of Alberta of Alberta based financial institutions.
November 15, 1988	Order of Justice Berger directing the Inspector to certify that evidence he has discovered tending to prove matters within his mandate that adversely impact upon any individual, corporation, or regulatory body has been put to the appropriate persons while they testified, failing which, the affected party shall be recalled before the Inspector and the Inspector's counsel shall put the evidence to that party; and, directing the Inspector to provide evidentiary excerpts affecting any person not continuously represented and an opportunity to respond. (*Re First Investors Corporation Ltd.; Re Associated Investors of Canada Ltd.* (1989), 63 Alta. L.R. (2d) 69)
November 15, 1988	Order of Justice Berger directing Inspector's counsel not be required to sum up or make closing arguments and directing procedures in the preparation of his final Report and allowing him to instruct his counsel and legal staff to assist in preparing portions of the final Report and draft his own conclusions after discussion with his counsel and legal staff.
November 22, 1988	Order of Justice Berger directing that the report of the expert, Gordon Barefoot, of Woods Gordon entitled "First Investors Corporation Ltd. — Simulated Earnings Analysis" is properly admissible in evidence before the Inspector. (*Re First Investors Corp. (No. 5)* (1989), 93 A.R. 359)
December 7, 1988	Order of Court of Appeal varying Order of Justice Berger dated November 15, 1988 to the extent that the Inspector is directed to give a notice to persons, individuals or agencies adversely impacted by his discovery of evidence tending to show matters in his mandate if he is not of the opinion that the substance of the evidence was put to the witness, failing which the witness has the obligation to indicate a desire to return to testify. (*Re First Investors Corporation Ltd.; Re Associated Investors of Canada Ltd.* (1989), 64 Alta. L.R. (2d) 1; 93 A.R. 335.)
February 2, 1989	Order of the Supreme Court of Canada dismissing a motion for leave to appeal the decision of the Alberta Court of Appeal of June 3, 1988 regarding the scope and validity of the Inspector's mandate.

February 14, 1989	Order of Justice Berger refusing an application by Donald M. Cormie that oral or written arguments to the Inspector cannot include submissions that the evidence before the Inspector tends to show the commission of a criminal or quasi-criminal offence or contain references to the criminal law, but directing that the Inspector shall not entertain submissions of counsel alleging that any individual corporation or government agency has committed fraud or any other illegal act or is liable for acts of negligence, wrongdoing or illegality.
February 17, 1989	Order of Justice Berger upon the application of Robert B. White, Q.C., Special Counsel for the investment contract holders, directing the Inspector to read written arguments notwithstanding some of the materials contained therein may be subsequently found by the court to offend previous directives of the court and directing counsel to notify the Inspector as to the passages of written arguments to which they object; and including a publication ban until the Inspector, or subsequently the court, has ruled thereon.
February 17, 1989	Order of Justice Berger upon the application of R.G. McLennan, counsel for Deloitte Haskins & Sells and of counsel on behalf of Donald M. Cormie that written arguments filed by counsel appearing before the Inspector shall not be released to the public and that oral argument shall be heard in public without live broadcast or transmission of the proceedings and directing a limited ban on publication of the arguments.
April 6, 1989	Order of Justice Berger upon application of counsel for the Inspector that the Inspector shall deliver the original of his final report to the court and that absent any order of the court to the contrary made on application prior to the delivery of the report to the court, the court may then without more, authorize the Inspector to file copies of his final report with the Clerk of the Court and distribute copies of his final report to counsel and release copies of his final Report to the public.
April 6, 1989	Order of Justice Berger refusing application of counsel for the Inspector to prohibit any person who obtains or receives a draft copy of the Report, or any documentation pertaining thereto, from publishing that information to any other person, except a person authorized by the Inspector.
April 18, 1989	Order of Justice Berger upon the application on John G. McNiven, Special Counsel for the investment contract holders that it is within the Inspector's mandate to consider whether there is evidence tending to show that PGL was a "scheme"; and, directing amendment of the written argument of Robert B. White, Q.C., after which unrestricted distribution of all written arguments filed by counsel before the Inspector was allowed.
May 4, 1989	Order of Justice Berger upon the application of counsel for the Inspector extending the deadline for delivery of the final Report to July 6, 1989.
May 4, 1989	Order of the Supreme Court of Canada dismissing the application of Donald M. Cormie for leave to appeal the decision of the Court of Appeal of December 7, 1988 regarding notice procedure.
May 30, 1989	Order of Justice Berger upon the application of the Inspector, advising and directing that the notice directed to be given in respect of the Inspector's opinion as to whether the substance of evidence has been put to witnesses includes the substance of opinion evidence given by experts.

July 6, 1989	Order of Justice Berger upon application of the Inspector extending the time and date for delivery of the final report to the Court to 9:00 a.m. July 18, 1989 and directing all counsel to attend in Chambers at the Law Courts, Edmonton at 3:00 p.m. July 18, 1989 to receive the decision of the Court as to whether or not the Final Report will be sealed or made public.

SCHEDULE B

CODE INVESTIGATION

MINUTES OF MEETING OF COUNSEL

No. 1

[August, 1987]

PRESENT: Wally McKall — Province of Alberta
R.B. White — Investors' Counsel
K. Davidson — Investors' Counsel
J.G. McNiven, Q.C. — Investors' Counsel
L. Robinson — Investors' Counsel
W. Severson — Investors' Counsel
J.N. Agrios, Q.C. — FIC/AIC/Principal Group
R.L. Duke — FIC/AIC/Principal Group
N.C. Wittmann, Q.C. — Code Investigation

The meeting was held at the offices of Cormie Kennedy in Edmonton and was called to order by N.C. Wittmann as Chairman according to the agenda attached [not attached in this Report]. The minutes will follow the items in the agenda by corresponding number and it is intended that if anyone present at the meeting wishes to correct or comment on the minutes, they will do so by corresponding with [N.C. Wittmann] with a copy to all of those present.

1. **Description of Mandate Powers of the Inspector**

N.C. Wittmann indicated that there may be some controversy about the mandate and the powers of the inspector based upon the definition of "affiliate" in the *Business Corporations Act*. This arose in part out of an application before Mr. Justice Berger made on Friday, August 28th, 1987 by Henry Beaumont, Q.C. on behalf of a Hutterite Colony, which was a creditor of Principal Group Ltd. He proposed that the Order of July 29th, 1987 containing the mandate of the inspector be clarified by deeming "affiliate" to include certain companies on what Mr. White called the "indirect control" principle. He also requested that they included, for greater certainty, Principal Group Ltd., Collective Securities Inc., Collective Securities Ltd. and any other shareholders of Collective Securities Inc.

The attached [not attached in this Report] organization chart of the Principal Group of Companies Canada dated December 31st, 1986 was attached to the material filed by Mr. Beaumont.

[N.C Wittmann] was asked to speak on the motion by Mr. Justice Berger and he indicated that on behalf of Mr. Code, that we regarded all of the bodies corporate as "affiliates" within the meaning of the *Business Corporations Act*, contained on the attached organization chart with the exception of MMI Holding Co., D.M. Cormie, James Cormie and John Cormie.

N.C. Wittmann repeated the position of Mr. Code, i.e., that he regarded his mandate as contained in paragraph 7.1, (a), (b), (c) and (d) of the July 29th Order to "conduct an investigation of the debtor company (AIC or FIC as the case may be) and any of its affiliated corporations (as such term if defined in the *Business Corporations Act*) to determine whether ". . . the business of the debtor company or of any of its affiliates . . .".

Mr. Code is of the view that the terminology "any of its affiliates" includes all of the companies on the attached organization chart save and excepting the exceptions mentioned above. N.C. Wittmann put the position as follows:

> If Company A controls 100% of Company B which controls 100% of Company C, then Company C is affiliated, not only with Company B, but with Company A.

Mr. Agrios and Mr. Duke took the position that they would have to take instructions with respect to this interpretation. There was a discussion as to whether or not an application ought to be brought before Mr. Justice Berger to clarify the interpretation and it was indicated that [Mr. Agrios] seemed to take the position that any application was premature at the moment and that the dispute would be crystallized either on a production of documents issue or an evidentiary issue. Mr. White indicated that after Mr. Agrios had considered his position, he would likely be making a formal request of Mr. Wittmann to make the application for clarification of the mandate and Mr. McNiven indicated that the mandate ought to be clarified at the beginning. Thus, [counsel present at the meeting] are awaiting some reply from Mr. Agrios in this regard. N.C. Wittmann did indicate that insofar as an investigation for the reasons for the financial failure of FIC and AIC were concerned, that Mr. Code did not regard his mandate as including an investigation for the reasons for the financial failure of affiliates as defined in the *Business Corporations Act*.

ACTION BY:

J.N. Agrios, Q.C. to state position of his clients with respect to the definition of "affiliate".

2. **Production of Documents**

(a) FIC/AIC/Affiliates

At the outset, Mr. Wittmann indicated that he would attempt to use the *subpoena duces tecum* power sparingly but that he would have no hesitation in issuing the same in the event that it appeared that some documents were being withheld or otherwise not being produced. Messrs. Agrios and Duke indicated that Code would have their full cooperation and are making a preliminary production before the end of this week.

ACTION BY:

Agrios/Duke to make available to or deliver to Wittmann the documents of FIC/AIC/Affiliates on or before September 4th, 1987.

(b) Investors

A number of Investors' complaints have been received by Code/Wittmann as the result of advertising and publicity. These documents are going to be made available to everyone insofar as it appears they will be used at the hearing.

ACTION BY:

Wittmann/McNiven/White in organizing investors' documents.

(c) Government

N.C. Wittmann indicated that he had agreed with J.C. Major that a production of government documents would occur on or before September 4th, 1987 and that J.C. Major would arrange to have the documents from the government, e.g., Alberta Securities Commission, Department of Consumer & Corporate Affairs, Provincial Treasurer, available for inspection this week. Mr. McKall indicated that it was Mr. Major's understanding that the documents would be made available to Wittmann/Code only and would not be disclosed to anyone else. Mr. Wittmann indicated that he thought that he would discuss Mr. Major's position with him with respect to disclosure of documents.

ACTION BY:

N.C. Wittmann to talk to J.C. Major about disclosure of government documents.

There was consensus among those present that whenever possible, all documents to be put forward at the hearing ought to be disclosed and circulated prior to the hearing or their introduction into evidence wherever possible. It was the consensus that surprise or the "ambush" approach likely would have little favour with Code unless one could demonstrate that it was absolutely necessary to expose a witness. Otherwise, surprise presentations of documents, especially lengthy documents would likely delay the conduct of the hearings and may invite a request for adjournment so counsel could study documents.

3. Conduct of the Hearing

(a) Location

The map attached to the agenda [not attached in this Report] with respect to the Canada Trust Tower space seemed to be the best location that anyone present at the meeting could suggest. Larger space was spoken of, but it was indicated by N.C. Wittmann that he had checked the Edmonton Convention Centre, for example, and that any space larger than a downtown office building would likely not be available for a continuous length of time. N.C. Wittmann indicated that subject to government approval in terms of the rent, the details of which were passed to Mr. McKall for transmission to Mr. Major, the Code Investigation would lease the space in the Canada Trust Tower and would make the improvements as indicated for a hearing room and offices adjacent thereto. Some of the offices may be available to counsel other than the Code Investigation and his staff, depending upon staff requirements. In any event, it would appear there will be room for the storage of documents and a system could be developed to store documents on a secure basis. N.C. Wittmann indicated that the space would likely be confirmed by the end of the week.

(b) Court Reporters/Clerks

The names of retired clerks were put forward as people that may be available. In addition, J.G. Moore Court Reporting Services had expressed an interest and due to their experience with past public inquiries, has demonstrated some expertise with respect to providing services. Garry Moore has spoken to N.C. Wittmann and Mr. Wittmann indicated that they would likely be appointed as the Court Reporters subject to approval of their rates.

(c) Media Access/Television

All counsel present expressed strong protestations with respect to allowing television cameras into the hearings. They strongly expressed their feelings and urged N.C. Wittmann to tell Code that they were vigorously opposed to live television coverage of the hearings. The reasons expressed were turning the hearings into a "circus", a "media event", and some counsel expressed the opinion that televising the hearings would likely prolong the same because then all of the participants' counsel would feel obliged to ask questions because they knew their clients would be watching on television. Other counsel expressed distaste for media treatment in terms of "editing" clips so as to distort the factual presentation and generally to sensationalize the hearings.

N.C. Wittmann pointed out the provisions of Justice Berger's Order of July 29th, 1987 in paragraph 7.3 (g) to the effect that without further order of the court, any hearings that the inspector does conduct will be "conducted in public and no ban on publication of evidence brought before any such hearing shall apply, nor shall any document relating to the present application be considered confidential". N.C. Wittmann also indicated that Code had been threatened by a reporter that if he didn't allow live television, that the reporter would apply to the court to get a Court Order. N.C. Wittmann also indicated that Code had made some inquiries and had been advised that the Estey Commission, the Hinton Inquiry, and the Mindbender Inquiry apparently all had live television coverage. It was again urged upon N.C. Wittmann by all those present to attempt to have Wittman prevail on Code to strenuously object to television or other photographic coverage of the hearings.

(d) Document Presentation

It was suggested by N.C. Wittmann that a number of documents would likely be tabled at the beginning of the hearing and marked as exhibits as "business records" under the exceptions to the hearsay rule under the *Evidence Act* or under the rule in *Ares* v. *Venner*. N.C. Wittmann expressed the view that he would like a number of documents to be tendered with the consent of the major participants and given that consent, Code would likely admit the same in evidence. [N.C. Wittmann] will not know what documents might be involved until [the investigation staff] have done a document inspection. There was a consensus that this idea seemed to be practical and advisable, but counsel generally wanted the opportunity to review any documents in advance of them being tendered at the hearing. N.C. Wittmann pointed out that that was implicit in obtaining consent or agreement to tender documents.

(e) Rules of Procedure

It was indicated by N.C. Wittmann that Code's view of the matter was that the Rules of Evidence would likely be followed fairly strictly, although Code was not bound by the technical Rules of Evidence. N.C. Wittmann indicated that Code was mindful that his mandate was in essence to determine whether or not there had been fraud or dishonesty in the conduct of the business affairs of various companies and that those findings involved matters of a grave or serious nature. Given the grave or serious nature of the findings and of the mandate, Code viewed the hearings and the matters he would rely on to take his report very seriously and was inclined to require that the Rules of Evidence applicable in a court room be followed. This is not to say that there may not be exceptions or exceptions by agreement. Everyone present seemed to appreciate this perception. N.C. Wittmann also indicated that it was not his intention to formulate any rules procedure in terms of writing out a set of rules, but that guidelines would be presented from time to time by Code/Wittmann in terms of the conduct of the hearings and that Code would rule on points of evidence, including admissibility, the conduct of counsel or of witnesses, as the occasion arose during the hearing.

(f) Presentation/Order of Presentation

Mr. White indicated that there were likely three major types of issues involved in fulfilling the mandate. The first was how did the investors get their dollars into FIC/AIC, the second was what happened to the money while it was in the companies or their affiliates (and thus why did FIC/AIC fail) and thirdly, what happened within the government while all this was going on.

This gave rise to an indication that the investors as a general category should go first, the companies second and the government third or perhaps the government second and the companies third. However there was a general consensus that the investors should go first. N.C. Wittmann indicated that the order of presentation should not detract from the ability of someone to request that a witness be called later, in essence out of order, to deal with some matter arising out of subsequent testimony.

It was also stressed that the present view of Code was that Wittmann should lead all of the evidence. Messrs. White and McNiven agreed. Mr. Agrios asked, when conducting interviews of witnesses prior to presentation, whether counsel would be entitled to be present and N.C. Wittmann indicated that any witness who wanted counsel present was, in his view, entitled to have such counsel present and indeed, invited to do so. N.C. Wittmann expressed that the reason for his presenting all of the evidence through witnesses was that Code's instruction was to keep control of the hearing in terms of its structure. Mr. Wittmann also stressed that if any major participant or indeed any member of the public wished a witness to be called, that the name and the evidence to be presented should be put to Mr. Wittmann. In the event Wittmann refused to put the evidence forward, a submission could be made to Code or perhaps directly to Mr. Justice Berger, if the dispute remained unresolved. In terms of the actual conduct of the hearings with Wittmann presenting the evidence, it was indicated that Wittmann would present the evidence much akin to a direct examination unless he was dealing with an obviously hostile witness. Thereafter the order of cross-examination, subject to Code's approval, would likely be that the "most adverse" party would cross-examine first and in descending order to the least adverse, cross examination would continue by other parties. N.C. Wittmann indicated that Code would not likely tolerate any "sweetheart" cross-examination. In other words, if Wittmann presented a witness from FIC/AIC, although Agrios/Duke would be entitled to "examine", they would not be entitled to cross-examine, but rather to ask questions for clarification.

(g) Venues other than Edmonton

N.C. Wittmann indicated that Code had been in contact with the investigation in British Columbia and Nova Scotia, that he was aware there were a number of investors in Saskatchewan, that the B.C. government had a lawyer in Edmonton, and that the Saskatchewan government had a lawyer in Edmonton. N.C. Wittmann indicated that it was the present view that [Code] would not likely be conducting hearings outside of Alberta and likely not outside Edmonton. There was a possibility that the hearing may move to Calgary at some time, but generally it was thought that if there were witnesses to come from outside of Alberta it may be cheaper to pay for the expenses of their attendance than to actually move the hearing. No one seemed to offer other views or comments in this regard.

(h) Commencement/Timing

N.C. Wittmann indicated that the present target was October 14th, 1987 and that because of the fact that no documents had yet been disclosed or presented to any great extent, [counsel] would have to "play it by ear". It was decided that any questions put to counsel for the various parties would be forwarded on to Code/Wittmann for response in terms of when the hearing would commence. With respect to the target date, N.C. Wittmann indicated he didn't want it publicized until [his staff] had an opportunity to organize documents in order that [counsel] might get a [b]etter "feel" for when the hearing might commence.

With respect to the time of the hearing from day to day, it was expressed that a 9:00 to 1:30 format would be preferable, as the time in the afternoon would be needed by counsel to prepare for the next day. N.C. Wittmann indicated that perhaps Code had intended a little longer day and all counsel present stressed that 9:00 to 1:30 was as much as could be usefully done in a day, it was tantamount to a full normal court day and that the counsel presenting the evidence would need every bit of the rest of the day in order to interview witnesses and marshall documents. A daily transcript is likely to be preferred.

4. Other Matters

(a) Expert

N.C. Wittmann indicated that Code was looking for a forensic accountant and was having difficulty finding one that didn't have a conflict. A number of names were discussed and it was indicated by N.C. Wittmann that the name of the person ultimately retained would likely be "run by" counsel in order that no one might raise a conflict at a later date.

The meeting was adjourned after it was indicated that there was a consensus regular meetings should be held on a "as needed basis".

CODE INVESTIGATION

MINUTES OF MEETING OF COUNSEL

No. 2

[September, 1987]

PRESENT: J.C. Major, Q.C. — Province of Alberta
N. Pollock — Investors' Counsel
W. Severson — Investors' Counsel
R.L. Duke/W. Kenny — FIC/AIC/Principal Group
Bruce Scott — Province of Saskatchewan
N.C. Wittmann, Q.C. — Code Investigation
W.E. Code, Q.C. — Code Investigation

The meeting was held at the offices of Code Hunter in Calgary and was called to order by N.C. Wittmann as Chairman according to the Agenda as attached [not attached in this Report]. The Minutes will follow the items on the Agenda by corresponding number and it is intended that if anyone present at the meeting wishes to correct or comment upon the Minutes, they will do so by corresponding with [N.C. Wittmann] with a copy to all those present.

1. **Business Arising Out of the Minutes of Meeting No. 1**

(a) Errors or omissions arising from the Minutes

None

(b) Clarification of meaning of "Affiliate" in Order (Agrios and Duke to take instructions)

Mr. Duke was called upon to indicate what his instructions were. He indicated that he was instructed to co-operate in every aspect and asked what documents were required by the various parties. He indicated he did not agree with Mr. Code's definition of "affiliate" in Order but that notwithstanding that disagreement he was willing and indeed had instructions to co-operate. A discussion ensued as to how far this "co-operation" would take everyone and whether or not there would indeed be a dispute as to the meaning of the word "affiliate". A discussion also ensued as to the June 30th, 1984 cut off date for the 7 intercorporate transactions as amended by an Agreement (letter) between Mr. White and Mr. Agrios to the effect that the date would be January 1st, 1984.

Mr. Code reiterated his definition of affiliate as used in the Order as set forth in the Minutes of the Meeting of Counsel No. 1. He also indicated that as far as he was concerned, any time constraint in terms of a 1984 date had only to do with intercorporate transactions and no other matters. Mr. Pollock summed up the issue and suggested that whether or not Mr. Duke or his client agreed with Mr. Code's definition of "affiliate", is it to be the case that Duke had an instruction to make available all documentation pertaining to the corporate entities according to Code's definition of "affiliate".

Mr. Duke indicated that he would consider the matter further and take an instruction. With respect to some specific documents, it was indicated that Mr. Wittmann wished to have the financial statements for Athabasca Holdings Ltd. and some of the other companies such as Matrix, Collective Securities Inc. for the last five years, together with the Minute Books and Director's Minutes.

ACTION BY:

Mr. Duke made a note of this and is going to indicate whether or not the same will be made available for Wittmann's inspection.

(c) Document Production FIC/AIC/Affiliates Documents

Wittmann indicated that he had received two binders of documents from Duke and Duke indicated that the document production was not yet complete and that there was some difficulty in coordinating the same between Coopers & Lybrand, Collins Barrow and Metropolitan.

ACTION BY:

Wittmann would write John Ryan, Steven Allan and Rob Pierce with copies to their counsel to attempt to get rid of any impediment to the production of documents.

(d) Wittmann/McNiven/White — Investor's Documents description by each as to what documents have been received and how they are being organized.

A discussion ensued as to the letter submissions being received by each party. Wittmann indicated that each document was being coded and that there was an attempt being made to categorize the kind of investor's complaint that was being received. It was also indicated that the documents were being filed in alphabetical order and by geographic territory and Mr. Wittmann requested that McNiven/White indicate to him which witnesses McNiven/White thought ought to be called. Once the investors' submissions are all documented they will be tabled and made available for inspection. At that time McNiven/White or any other party can indicate which investors they think ought to be called.

ACTION BY:

Wittmann/McNiven/White to table all complaints and make them available for inspection and to indicate which investors are going to be called as witnesses.

It was also indicated by Mr. Duke that there would be a file on each investor and Mr. Wittmann indicated that so soon that it had been determined that an investor was going to be called as a witness, [Mr. Wittmann] wanted production of the investor's file from Mr. Duke. [Mr. Wittmann] also wanted the names of at least the five top producer consultants selling investment contracts and Mr. Duke indicated he was going to get those names to Mr. Wittmann.

(e) Wittmann/Major — disclosure of government documents

Wittmann indicated that the Government had made an extremely full production and that Major had indicated to him that solicitor/client privilege would be waived and that the only thing that may not be available are the Minutes of cabinet meetings, if any. If any such Minutes exist pertaining to the Code mandate, Major will indicate whether or not he has an instruction to assert a Crown privilege to the production of such Minutes. The Government production goes back to 1948 and is extremely voluminous. When the Code staff is through reviewing the documents, the Government production will be made available to all counsel and Wittmann will indicate what portions of the Government production he intends to put forward at the hearing.

2. **Conduct of the Hearing**

(a) Location

Wittmann distributed a letterhead (attached hereto) [not attached in this Report] indicating the addresses and phone numbers for the Edmonton and Calgary offices of the Code investigation. The Calgary office is the office of Code Hunter but has a separate telephone line for the purpose of the investigation.

The Edmonton office is in the Imperial Oil Building at the corner of 100 Street and Jasper Avenue on the 17th Floor. Wittmann showed all concerned a drawing of the floor plan and invited comments. There was specific discussion of providing offices to White/McNiven/Duke or any other party. Major indicated that the government was not going to provide office space for project teams to work out of. There were, however, to be three extra 10 x 15 offices in the space to be made available to counsel for use by counsel during the hearings. Major indicated that it was the Government's position that the Government shouldn't be providing office space for people with law offices in Edmonton. If the concern was secure storage of briefcases, papers, files, during the hearing or a place to interview witnesses or make telephone calls during the hearing, the three offices indicated were intended to provide this function. No one commented on this fact and everyone seemed to accept the stated position in this regard. Major also indicated that he had yet to hear from White or McNiven with respect to proposed fee schedule or payment structure and suggested that White and McNiven contact him with a proposal in this regard if they expected to be paid to ensure there was no miscommunication as to fees or fee expectations.

ACTION BY:

White and McNiven to contact Major with respect to fee expectations.

(b) Court Reporters/Clerks

Wittmann indicated that Garry Moore would be the court reporter as he had considerable experience in recent inquiries. It was decided that daily transcripts would probably not be required with this matter to be brought up again either at the beginning of the hearing or at the next meeting of counsel. Code or Wittmann will make arrangements to have a clerk present.

(c) Media access/television

A great deal of discussion ensued about televising the hearing. Code indicated that he was inclined to let one television camera, with one feed, televise the entire hearings. The admittance of television cameras to the hearing was protested by all counsel present except Wittmann. The views expressed were:

1. That television would result in over-sensationalizing the hearing by the selective editing of various portions of the hearing;
2. Television would fetter or otherwise disturb the candor of witnesses and would otherwise unsettle them.

After much discussion Code indicated that he had heard nothing that persuaded him not to have television in the hearings but that he would take a final decision later. One compromise that was suggested was to allow the cameras in for 10 or 15 minutes at the beginning of the hearing each day and then expel them from the room.

(d) Document Presentation

This item appeared to present a significant problem in that Justice Berger's Order of July 29th, 1987 indicates that there shall be no ban on the publication of evidence. [I]t was pointed out by Wittmann that if documents were tendered by agreement, that they became "evidence" at the beginning of the hearing, then the press was at liberty to inspect the same and to publish the same and to publish stories about the same long before a particular document might ever be the subject of *viva voce* testimony during the hearing. A great deal of discussion surrounded how to deal with this problem. Both Duke and Major expressed concern about this happening and ultimately it was decided that Duke would write Wittmann a proposal to protect the premature publication of documentary "evidence". Wittmann indicated that likely the only way to overcome this was to have all counsel agree as to what could become evidence and tendered as such without further proof thereof and to tender documents piecemeal during the hearing. The documents, however, could be pre-marked as exhibits.

Wittmann raised the idea that he had heard from one of the investor's counsel, or someone in their offices that statutory declarations were being proposed to be brought forward. Mr. Pollock indicated that this indeed may be the case and that it was important to the investors to put a number of stories forward, not just "representative" versions of how they came to invest. It was suggested that a statutory declaration be put forward on the basis that if any other adverse party wished the witness called in person to give *viva voce* evidence, that they could so require it. Duke objected to this process. Major seemed to accept that in the context of Code's mandate it would be difficult to avoid proceeding in this fashion or in a fashion like it. Code indicated that he was not going to conduct hearings so as to hear testimony from thousands of witnesses. Although it was not specifically agreed at the meeting, it is appropriate that White/McNiven indicate their proposal for putting forward investors' complaints by volume.

ACTION BY:

Duke to write proposal to Wittmann for the presentation of documentary evidence so as to ensure the timely publication of the same.

White/McNiven indicate proposal for putting forth investors' complaints, which proposal is to be put to Mr. Wittmann.

(e) Presentation/Order of Presentation

Everyone reaffirmed that the presentation and order of presentation would be that generally speaking the investors would go first, followed by the salesmen, the corporate executives and the government.

(f) Venues other than Edmonton

None and no one commented adversely on Mr. Code's position in this regard.

(g) Commencement/Timing

After a great deal of discussion, the commencement date remained October 14th, 1987 and it was indicated to all of those present that this would be announced shortly after the meeting. Mr. White, through Mr. Pollock, indicated that he wanted the hearings to start with him present and that he was likely not available the week of October 19th, 1987. Other counsel indicated that they had problems attending and would be sending alternates from time to time. It was agreed, for the time being, after much discussion about how long during the day to sit, that the hours of sitting would be 9:00 to 12:00 and 2:00 to 5:00, with expedited, rather than daily transcripts. It was also agreed that in consideration of sitting long hours, i.e., 6 hours per day, that [the investigation] would sit 4 days only per week to begin with Monday through Thursday and presumably the first week the 14th and 15th.

(h) Witnesses

As far as is possible, the names of witnesses will be circulated in advance the day before they are to be called so that counsel may have an opportunity to review any documentation which may pertain to a witness. The problem of investors as witnesses and statutory declarations was discussed elsewhere. Duke again asserted that there were certain key executives Principal Group that he wished to call and didn't feel it was proper for the Inspector's counsel to call those witnesses. Major was happy to have the Inspector's counsel to call all Government witnesses. Code indicated that it was his preference that the Inspector's counsel call all of the witnesses in the first instance. Thereafter, near the end of the hearing, if some one or more of the parties wanted to call witnesses not put forward by the Inspector's counsel, they would likely be at liberty to do so, subject to the Inspector being satisfied as to the relevancy of the testimony. There was much discussion about whether or not the Inspector's counsel was capable of presenting witnesses "belonging to" the parties and Duke again asserted his position that he did not wish the Inspector's counsel to call senior executives of the Principal Group but wished to do it himself. Code did not accede to this proposition.

3. **Other Matters — Expert Witnesses**

   Code indicated that he was trying to hire an accountant, but had not yet been successful. Some names of some accountants were brought up to see if there was any potential conflict. Code indicated that he was inclined to speak with Clarkson Gordon and Thorne Ernst and Whinney and Dunwoody & Company.

4. **Other business**

   None

CODE INVESTIGATION

MINUTES OF MEETING OF COUNSEL

No. 3

[October, 1987]

PRESENT: G. Rippon — B.I. Robertson & Associates
D. Carroll — B.I. Robertson & Associates
K.J. Chapman — Ken Marlin
W. LeClair — Investors' Counsel
J.G. McNiven, Q.C. — Investors' Counsel
W. Kenny/R.L. Duke — FIC/AIC/Principal Group
B. Scott — Province of Saskatchewan
W. McKall — Province of Alberta
K. Davidson -- Investors' Counsel
R. White, Q.C. — Investors' Counsel
P. Stanton — Collins Barrow Limited
B.A.R. Smith, Q.C. — Collins Barrow Limited
J.T. Eamon — Code Investigation
C.M. Skene — Code Investigation
N.C. Wittmann, Q.C. — Code Investigation

The meeting was held at the offices of the Code Investigation in Edmonton and was called to order by N.C. Wittmann as Chairman according to the Agenda as attached [not attached in this Report]. The Minutes will follow the items on the Agenda by corresponding number and it is intended that if anyone present at the meeting wishes to correct or comment upon the Minutes, they will do so by corresponding with Mr. Wittmann with a copy to all those present.

1. **Errors or omissions arising from minutes of last meeting**

None

2. **Procedure for document disclosure and review**

Mr. Wittmann confirmed that most of the parties had signed the undertaking prepared by him with respect to reviewing the government documents. Mr. McKall confirmed that there had been full disclosure of all documents by the government and subject to receiving the undertaking, it was their position that any of those lawyers, but not their clients, could review the same.

Reproduction of Documents

Mr. Wittmann stated that Mr. Eamon was making arrangements to reproduce all the documents presently coded. A sheet of paper was passed around the meeting whereon the parties could indicate whether they wished to order a complete set of documents. It was anticipated by Mr. Wittmann that the first batch would be available for distribution prior to the weekend. Once a further batch of documents had been coded and xeroxed, Mr. Eamon would arrange the copying of these as well.

Mr. Wittmann stated that Mr. Major had waived any privilege that may attach to the government documents including any cabinet meeting minutes.

Mr. McNiven expressed concern that Code's staff, when reviewing the government or any documents, would take their own view with respect to what was relevant. That perspective may in fact be different from the perspective of the investors. While Mr. White stated that his staff did not wish to duplicate the effort of Code's staff, Mr. McNiven stated that he continued to have concerns, and wished to consider the same prior to discussing it further.

ACTION:

Mr. Eamon is to provide the parties with a copy of the source prefix numbers in order that those people reviewing the documents would be aware of the venue where they originated.

Mr. Eamon is going to inquire into the ability of other parties to access the information being placed in the Code Investigation computer system.

Statutory Declarations

The issue with respect to leading evidence by way of statutory declaration was discussed. Mr. White stated that beween Mr. McNiven and himself, they propose to tender the evidence of approximately 200 investors. As they would be attempting to establish that the misrepresentations allegedly made were not isolated events, he provided alternatives with respect to how same could be done in a minimal amount of time. First, they could call two or three investors with respect to each misrepresentation, and thereafter call the salesman involved, for the purpose of establishing that that particular salesman or salesmen were making those misrepresentations to numerous other investors. Secondly, White could call two or three representative investors to establish a misrepresentation, and in addition table 10 or 12 statutory declarations with respect to similar misrepresentations. It would also be open to the company's lawyers to cross-examine two or three of those investors who had signed statutory declarations. It would be open to the companies to respond to the statutory declarations by leading their own evidence. These alternatives were expressed for the purpose of discussion, as Mr. White stated that there were a number of ways to present the evidence without the necessity of calling every investor.

Mr. Duke stated that they had not decided what their position would be with respect to statutory declarations, as they first wanted to review the investors' files and alleged misrepresentations.

Mr. White confirmed that he did not want to lead any unnecessary evidence, but was looking for a compromise to calling every investor.

There was no resolution of the statutory declaration issue at present.

Affiliates and Principal Documents

With respect to document disclosure and review, the affiliate issue was discussed by Mr. Duke. He stated that he had written Mr. Wittmann a letter stating that he was prepared to concede on the matter of the "affiliates". To the extent that documents and evidence with respect to Collective Securities Inc., Athabasca Holdings Ltd., Principal Securities Management and others were relevant, the same would be produced.

When asked whether the Principal Group had produced their documents, Mr. Duke brought up the difficulties he was having as Collins Barrow and Coopers & Lybrand were in possession of a great deal of the documentation.

Mr. Wittmann stated that this initially was a problem, but that he perceived a great deal of cooperation from Collins and Coopers at this point in time.

Amendment to Order

Mr. Smith stated that he had received instructions to request that the Order of Mr. Justice Berger be amended to include Principal Group Ltd. and its affiliates, thereby extending the Code investigation mandate to include any investigation as to the reasons for the failure/bankruptcy of PGL. Mr. Smith inquired as to whether any of the parties present had any compelling arguments with respect to making the application before Berger, J. prior to the commencement of the hearings and further inquired as to whether any of the parties present would be objecting to such an application.

Mr. Wittmann confirmed that he and Mr. Code were of the opinion that it was not appropriate for them to comment on the scope of their mandate, but he suggested that it would be prudent to approach Mr. Justice Berger prior to October 14, 1987. Mr. Duke stated that he would have to seek instructions with respect to consenting to such an order.

3. **Procedure for interviewing witnesses**

It was agreed that should it be necessary for the parties to interview potential witnesses, the witnesses' counsel would be invited to attend those interviews. Mr. Duke confirmed that Cormie Kennedy was representing the employees of the companies at the level of area managers and up. They do not represent the salesmen.

Mr. McNiven was concerned with respect to the Public Services Act and the oath of secrecy taken by employees, past and present, of the government. Mr. McKall confirmed that should any cabinet ministers be called to give evidence, the Lt. Governor will be signing appropriate dispensations with respect to their evidence. As well, an appropriate release was being drafted for the employees which would allow the employees to give evidence. To the extent that any past or present employee was in breach of the Public Service Act prior to testifying, the release would not provide them with immunity for those acts.

4. **Conduct money for witnesses**

Mr. Wittmann stated that conduct money would be paid to the witnesses in accordance with the Rules of Court and that out of town witnesses would have their travel expenses provided for. Edmonton witnesses will not be provided with conduct money.

5. **Conduct of the public hearings**

(a) The hearings are to commence October 14th, continue October 15th, October 16th and weekly thereafter Monday through Thursday.

(b) Mr. Wittmann stated that Mr. Code had expressed that he was flexible with respect to the hours. Mr. Eamon commented that the public notices stated that the hearings commenced at 9:00 in the morning. Therefore, it was the consensus that the hearings would sit from 9:00 a.m. to 1:30 in the afternoon, commencing the first day of the hearings.

(c) Transcripts

A brief discussion entailed with respect to whether parties wanted the transcripts to be prepared on a daily basis, or whether an expedited turn-around time would be sufficient for all purposes. The consensus was that there was no need to have transcripts prepared the same day that the evidence was given, but that the expedited turnaround time was sufficient. The transcripts are also being placed on disks.

(d) Order of presentation

It was proposed by Mr. Wittmann that the order of presentation with respect to the evidence of the investors would be as follows: Wittmann, (McNiven), (White), Major, others, Chapman, Duke, Wittmann, Code.

A discussion ensued with respect to the need for Mr. McNiven or Mr. White to rehabilitate or have a chance to not only clarify the evidence after Mr. Wittmann's initial examination, but as well to redirect after the cross examination by Mr. Chapman or Mr. Duke.

ACTION:

Mr. Wittmann would specifically go over the concerns of the parties with respect to the order of presentation with Mr. Code and confirm the order of presentation at his earliest convenience.

(e) Deadlines for listed investor witnesses and availability of branch files for such witnesses

Messrs. Wittmann, White and McNiven will be meeting on Wednesday, October 7th and a list of investors will be formulated at that time. Messrs. White and McNiven will provide Mr. Wittmann with their investor files, including a brief summary of the witnesses' evidence. Upon receipt of this list, Mr. Wittmann will arrange for the production of the branch files for each witness.

6. Questions arising out of Code's Interim Report

Messrs. Duke and Chapman stated that they were surprised at the breadth of the issues outlined in the Interim Report. They stated that from their standpoint, the sources of funds and the ratios were more applicable to a bank than to an investment contracts company. There was a brief discussion between Mr. Eamon and Mr. Duke/Chapman. Mr. Wittmann stated that if they chose to take issue with the Interim Report, the Code Investigation would request some notice of their objections prior to any formal action before the Code Investigation or otherwise. Mr. Duke stated that they may address this point at the outset of the hearings. Mr. Wittmann stated that he would like formal notice of the same as early as possible if in fact they decided to make any submissions.

7. Other business

Mr. Wittmann confirmed that Mr. Code had decided to allow one television camera in the hearings. Numerous parties made their objections known briefly, as the same had been debated at a previous meeting. Mr. Wittmann commented that should these strong feelings with respect to the use of television persist, that the parties could take this up directly with Mr. Code. Further, another option was to attend before Berger, J. and request that the television camera be removed. As well, should an abuse of the process take place, Mr. Code had the power to exclude the camera from the hearing.

CODE INVESTIGATION

MINUTES OF MEETING OF COUNSEL

No. 4

(November 5, 1987)

PRESENT: Neil C. Wittmann, Q.C. — Code Investigation
Jim Eamon — Code Investigation
Pat Bentley — Messrs. Moulton, Pearce, Patrick, Johnson & Ritchie
Dennis Picco — B.I.R.A.
Colleen Kenny — Collins Barrow Limited
William Kachman — Ken Marlin
W.J. Kenny — Senior Management
J.G. McNiven — Investors' Counsel
Walter S. McKall — Province of Alberta
Robert B. White, Q.C. — Investors' Counsel
K. Davidson — Investors' Counsel

The meeting was held at the offices of the Code Investigation in Edmonton and was called to order by N.C. Wittmann as Chairman according to the Agenda as attached [not attached in this Report]. The Minutes will follow the items on the Agenda by corresponding number and it is intended that if anyone present at the meeting wishes to correct or comment upon the Minutes, they will do so by corresponding with Mr. Wittmann with a copy to all those present.

1. **Errors or omissions arising from minutes of last meeting**

   None

2. Conduct of hearings

   (a) Procedure outside of hearings:

   Mr. Wittmann commented that the use of Mr. Code's offices indiscriminately by some other counsel was causing a problem in terms of space and the use of photocopiers. While Mr. Code's counsel have extended an invitation to all counsel to have access to documents in his office, Mr. Wittmann requested that all counsel attempt to accommodate Mr. Code's people in order that they are able to perform their function. Priority for access to Mr. Code's facilities and people would be allocated to the then next witness and when the documents are ready, other counsel would receive them.

   No complaints were expressed regarding access to Mr. Code's documents or staff. Mr. Wittmann stated that Mr. Code's people would try to accommodate all requests, subject to availability of space and facilities. Mr. Eamon stated that in many cases he had authorized some counsel to review certain documents, but in other cases such counsel were not authorized. The problem stemmed in part from a lack communication within Mr. Code's office.

   (b) Procedure at Hearings

   It was agreed that the current hours of sitting would continue.

   Counsel were invited to consult a calendar in Mr. Wittmann's office which showed the schedule of hearings regarding the salesmen, which was always subject to change. Mr. G. Randall would be called on November 9th, followed by Mr. D. Slater.

   A bundle of sales and marketing related documents would be available for pick-up Friday noon.

   Mr. Wittmann advised that the documents would be tendered as pre-marked exhibits, all of which might not be identified by a witness when entered. The custodian of the documents would not be called. Mr. Wittmann requested that if a counsel wished to object to this procedure, notice should be given by 8:30 a.m., November 9, 1987.

Mr. Wittmann advised that he would enter as exhibits any investment contracts which the salesmen witnesses had purchased. In addition, he would be putting to the witness those portions of the transcript of past proceedings where an investor witness had mentioned the salesman, and would be asking the salesmen whether they made such statements. Mr. Wittmann had advised the [s]alesmen that in response to such transcripts, they have three alternatives: Deny the statement; explain or modify the statement; or admit making the statement. In addition, salesmen were being advised that they could bring counsel to the interview with Mr. Wittmann and to the hearing.

Mr. Wittmann advised that he would first call the salesmen and senior account executives. Thereafter, branch managers, area managers and regional managers would be called. However, senior management would not be called at this time since they performed more than one function.

Mr. Wittmann advised the examination of all of the sales related witnesses under the level of trainer and J. Moulton, would take three weeks in November, but that this may be an optimistic assessment. Mr. G. Randall performed some training and would therefore be called first.

Mr. Wittmann indicated that, at present, it is planned that after the sales witnesses, witnesses involved in the marketing function would be called, followed by witnesses involved within the investment function, followed by the financial function. There would then be an attempt to draw the investment and financial functions into the regulatory aspect of the corporate management.

In all cases, Mr. Wittmann advised that he would stop short of senior management responsible for the functions of sales marketing, investment, and finance. Senior executives would be called at the end of the management segment in all likelihood, although no final decision had been taken. Mr. Wittmann's preference was to call each witness only once, and therefore, senior management, who exercised more than one function, would be called at the end of the management segment of the evidence.

Mr. Wittmann stated that [the investigation] would be lucky in the extreme to get through Principal management (excluding senior management) by Christmas. Mr. Wittmann stated that he would prefer to break on December 17, 1987. Mr. Code had not yet considered the matter of a Christmas break.

Mr. Wittmann advised that auditors from the firm Deloitte Haskins & Sells would likely be called as witnesses and perhaps also members of Touche Ross. No decision had been taken as to when these auditors would be called, although they may be called before evidence is given by senior management.

Mr. Wittmann advised that government officials would not be called as witnesses before January, at least in the case of cabinet ministers.

Mr. Wittmann advised that Grant Mitchell would probably be called. Messrs. Bentley, Kenny and McKall advised that they did not represent Mitchell.

Mr. Wittmann described briefly the application to be brought against the Canada Deposit Insurance Corporation to compel it to produce all documents in its possession, and stated that the application would probably be made on November 26th (now definitely December 3rd). A subpoena would not be served on the Canada Deposit Insurance Corporation.

Mr. Wittmann advised that Mr. Code wanted to sit six weeks over the months of January and February, 1988, during which time evidence would be heard from either top management, or government officials, or both. Mr. Wittmann was unaware whether sittings would be held during the Winter Olympics. Mr. Code had not yet addressed that matter. Some counsel (Mr. McNiven and Ms. Kenny) advised that they had made time commitments to act as volunteers during the Olympics. Mr. Wittmann is to pass this information on to Mr. Code.

Mr. Wittmann advised that on November 11, 1987, the hearings would sit, but that Mr. Code would require all present to observe silence at 11:00 a.m. Messrs. Kenny, White and McNiven objected to sitting on Remembrance Day. Mr. Wittmann agreed to bring the matter back to Mr. Code's attention.

3. **Shaw Cable Proposal**

Those present were provided with a copy of the proposal made by Shaw Cable (attached). Mr. Code joined the meeting and stated that while Shaw Cable originally requested permission to install one camera, it was now requesting two, thereby allowing it to switch cameras. Mr. Code stated that he has not happy with a camera behind the witness. Some counsel had objected to T.V. coverage. Mr. Code asked for their views and stated that his own view was that, to date, such coverage had not created a problem.

Mr. Kenny stated that while the camera did not appear to bother the witness, the coverage was distorted.

Mr. White and Mr. McNiven expressed their view that, now that the decision had been made, there would be no harm in additional coverage.

Mr. McKall expressed Mr. Major's objection to television coverage.

Mr. Code expressed a preference against two further cameras. Mr. Wittmann agreed. A single camera would be allowed.

There was some discussion as to where a single additional camera would be placed.

Mr. Code left the meeting.

4. **More Investor Witnesses**

Mr. White withdrew the request.

5. **Hours and dates of sittings**

Mr. Wittmann advised that while the current schedule appeared to be working, it was possible for him to extend the length of a hearing day. Mr. McNiven and Mr. White expressed their preference that the current schedule be maintained, and Ms. Kenny expressed her satisfaction with the current schedule. Accordingly, it was agreed that for the time being, the current hours of sitting from 9:00 a.m. to 1:00 p.m. (with extensions, where necessary) would be maintained.

Mr. Bentley advised that it was likely that either Phil Warner or Jeff Champion of his office would be present at the hearings.

6. **Other business**

Mr. Kenny referred to page 6 of the minutes of meeting no. 2, and understood that there was an agreement that any counsel who wanted to call other witnesses near the end of the hearings would likely be permitted to do so. He stated that Mr. Code appears to want such witnesses to be called after each segment of the evidence was completed.

Mr. Wittmann advised that the minutes should not be taken as meaning that other counsel were able to call witnesses; rather, Mr. Wittmann would call each witness and lead that witness, in any event. He expressed his opinion that what Mr. Code was saying was that the hearings should be carried on in an orderly manner; however, if a counsel wishes that a necessary witness be called at the end of the hearing and that witness was recently discovered, Mr. Wittmann doubted that Mr. Code would exclude that witness from giving evidence. Mr. Wittmann agreed to clarify this matter with Mr. Code.

Mr. Kenny asked whether Mr. Wittmann would lead any experts called by Mr. Kenny. Mr. Wittmann stated that that may be an exception to the rule. The matter of calling witnesses from Investors' Syndicate in order to give evidence as to their practices was then discussed. Mr. Wittmann expressed his view that as the bulk of the evidence given by such a witness would be a matter of fact, Mr. Wittmann would probably lead that witness.

Mr. Wittmann expressed his current thinking that much factual evidence would be put on the record through members of Clarkson Gordon, although he stated that no decision had yet been taken as to whether Clarkson Gordon would be called. In his view, it would be more efficient to reconstruct financial information through evidence given by Clarkson Gordon.

Mr. Kenny inquired whether Clarkson Gordon would be called before Mr. Bentley's clients were called. Mr. Wittmann stated that this would not be the case for Mr. Moulton, but may be the case for Mr. Johnson. The matter of whether and when members of Clarkson Gordon would be called as witnesses was to be considered by Messrs. Wittmann, Eamon, Code and members of Clarkson Gordon at an up-coming meeting among those parties.

Mr. McNiven inquired whether Clarkson Gordon would give an expert opinion as to the business reasons for various transactions. Mr. Wittmann advised that Clarkson Gordon, if they were to testify, would place in evidence, for example, an analysis of intercorporate transactions, which analysis would be expected to be simple and concise. A decision had not been taken as to whether Clarkson Gordon would give opinion evidence, although they are experts. This matter was to be held in abeyance for the time being.

Mr. Wittmann stated that it would be unseemly for him to call the experts of Messrs. White, McNiven and Kenny. This matter was to be raised again by Mr. Kenny at a later time.

Mr. Kenny asked when the accountants retained by him and Mr. White would testify. Mr. Wittmann stated that he had no fixed views on this matter and stated that Mr. Kenny may wish his expert to testify immediately after the members of Clarkson Gordon. No resolution on the matter was achieved and this was to be raised at a later date.

Mr. McKall asked that advance notice be given to him when Mr. Code's counsel wished to subpoena government officials.

Mr. Kenny raised the issue of video tape evidence. Mr. Wittmann stated that some salesmen have seen video tapes and have stated that the material on those tapes influenced their presentations to their clients. The tapes could be left out of evidence, entered into evidence, or actually watched during the hearing. Mr. Wittmann was not inclined to put the whole tape in evidence by viewing it, but if any counsel wanted to view the tape in the hearing room as part of the evidence, Mr. Wittmann asked that advance notice be given in order to consider the request and arrange for the necessary facilities.

Mr. Wittmann raised the issue of whether witnesses would be excluded. Mr. White replied that this appeared to be a "non-starter". The matter was not further pursued.

The meeting was then adjourned, there being no further business.

CODE INVESTIGATION

MINUTES OF COUNSEL MEETING

No. 5

(Monday, December 1, 1987)

PRESENT: W.E. Code, Q.C. — Code Investigation
N.C. Wittmann, Q.C. — Code Investigation
L.A. Taylor — Code Investigation
C.M. Skene — Code Investigation
J.T. Eamon — Code Investigation
J.P. Warner — S.W. Johnson et al
J.B. Champion — S.W. Johnson et al
R.L. Duke — Donald Cormie et al
W.J. Kenny — Donald Cormie et al
R.B. White, Q.C. —Investors' Counsel
K.H. Davidson — Investors' Counsel
C.K.W. Thietke — Investors' Counsel
W.S. McKall — Province of Alberta
P. Stanton — Collins Barrow

The meeting was held at the offices of the Code Investigation in Edmonton and was called to order by N.C. Wittmann as Chairman according to the agenda attached [not attached in this Report]. The minutes will follow the items on the agenda by corresponding number and it is intended that if anyone present at the meeting wishes to correct or comment upon the minutes, they will do so by corresponding with Mr. Wittmann with a copy to all those present.

1. **Report of Anticipated Witnesses**

Mr. Wittmann stated that the order of the next few witnesses is as follows: Mathes, Green, Frazier, Mitchell and Johnson.

2. **Scheduling**

(a) Hours

In an attempt to move the Inquiry along at a faster pace, it was suggested and the Inspector agreed that the hearing would sit from 9:00 a.m. to 2:30 p.m.

(b) Days

It was discussed and agreed by the Inspector that the hearing would not be extended to Friday, but would continue sitting from Monday through Thursday.

(c) Christmas Break

It was confirmed by the Inspector that the hearing would adjourn for the Christmas break on December 17, 1987 to resume on Monday, January 4, 1988.

(d) 1988 Schedule

Discussion ensued with respect to whether there would be an adjournment for the 1988 Calgary Winter Olympics. No firm decision was arrived at. Those present appeared to be divided on the issue.

3. **Documents/Evidence**

(a) Presentation of Exhibits

With respect to the reproduction of documents already included in previous exhibits, it was the general consensus of those present that for ease of reference, those pertinent parts of [p]revious exhibits would be reproduced and form a part of the exhibits tendered for subsequent witnesses.

(b) Accounting Evidence

Mr. Wittmann advised that it is his intention to enter as exhibits summaries of 20 intercorporate and other transactions to [p]rovide the factual basis of the transactions. At a later date, it is his present intention to call Clarkson Gordon for their opinion respecting the transactions. Clarkson Gordon exhibits would be entered in series as exhibits during the testimony of S.W. Johnson, the VP of Finance for PGL.

Mr. Wittmann also advised that it was his intention to have a visual aid prepared by Baker Lovick with respect to the transactions and the affiliated companies.

Mr. Duke commented that he would like to review the transactions prior to expressing his approval or otherwise.

Mr. Wittmann commented that if upon review of the summaries, should anyone have corrections or comments to please advise him as soon as possible.

The transaction summaries could be subject to the lawyers' undertaking with respect to the release of documents.

4. **Other Business**

(a) Argument

Mr. Duke inquired whether there would be argument submitted at the end of the hearing. Mr. Code said yes, excluding Mr. Wittmann.

Discussion ensued with respect to written argument. Mr. White commented that it would be faster to do argument orally. Mr. Code expressed his opinion stating that should written argument be submitted, he did not wish the same to delay the hearing in any way.

Mr. Wittmann suggested a compromise where any written argument would have to be submitted before or concurrent with oral argument.

No final decision was made with respect to written argument.

(b) Government Documents

It was suggested that the Code Investigation should prepare a more concise collection of pertinent government documents. Mr. Wittmann advised that it was his intention to do so.

CODE INVESTIGATION

MINUTES OF COUNSEL MEETING

No. 6

(Tuesday, May 24, 1988)

PRESENT: W.E. Code, Q.C. — Code Investigation
N.C. Wittmann, Q.C. — Code Investigation
L.A. Taylor — Code Investigation
C.M. Skene — Code Investigation
J.T. Eamon — Code Investigation
J.B. Champion — S.W. Johnson et al
W.J. Kenny — Donald Cormie et al
J.W. Yurkovitch — Donald Cormie et al
R.B. White, Q.C. — Investors' Counsel
J.E. Topolinski — Investors' Counsel
C.K.W. Thietke — Investors' Counsel
S.L. Harper, Q.C. — Christa U. Petracca
J.C. Major, Q.C. — Province of Alberta
R.M. Kruhlak — Deloitte, Haskins & Sells
D.L. Picco — B.I. Robertson & Associates
K.J. Chapman — Ken Marlin
C.L. Kenny — Collins Barrow Ltd.

The meeting was held at the offices of the Code Investigation in Edmonton and was called to order by N.C. Wittmann as Chairman according to the agenda attached [not attached in this Report]. The minutes will follow the items on the agenda by corresponding number and it is intended that if anyone present at the meeting wishes to correct or comment upon the minutes, they will do so by corresponding with Mr. Wittmann with a copy to all those present.

1. **Approval of Minutes of Meeting No. 5**

2. **Scheduling of Witnesses**

   Mr. Wittmann stated that the order of the next few witnesses is as follows: Stefanski, Espenberg, Halvorson, Ryan, possibly Agrios, Fuhr, Wooldridge, Touche Ross, Deloitte, Haskins & Sells.

   Mr. Wittmann advised that should any counsel want a particular witness called, that they should let him know at their earliest convenience. In response to a comment by Ms. Harper, Mr. Wittmann stated that it was not necessary to make a decision immediately.

3. **Next Break**

   After some discussion, Mr. Code decided that the Hearing would not sit during the first two weeks of August.

4. **Submissions of Counsel**

   (a) Order

   It was decided that the order of oral argument would be as follows:

   1. Investors Counsel
   2. Collins Barrow
   3. B.I. Robertson & Associates

4. Coopers & Lybrand
5. Company Directors/Officers/Employees
6. Government of Alberta

(b) The submission of written argument is optional. Those who wish to have written argument considered by the Inspector must have the same delivered to his office within seven clear days from the last day of evidence. Thereafter, oral argument will not commence sooner than four clear days (the same is at the request of Mr. White).

Oral argument will take place in the order as set out above. There will be no oral rebuttal evidence. At the close of oral argument, should any counsel wish to submit further written argument in the form of a reply to either the oral or written argument of other counsel, the same must be delivered to Mr. Code's offices within seven clear days of the end of oral argument.

Mr. Wittmann stated that at this time it was not his intention to participate in argument before Code.

5. Notice Akin to s. 12 of the Public Inquiries Act

After some discussion, it was decided that all counsel would wait until the Court of Appeal decision was rendered, at which time each of the parties affected would consider their options and discuss further their position with respect to receiving a notice akin to s. 12 of the Public Inquiries Act.

6. Other Business

There was no other business discussed.

CODE INVESTIGATION

MINUTES OF COUNSEL MEETING
No. 7
(Wednesday, October 12, 1988)

PRESENT: N.C. Wittmann, Q.C. — Code Investigation
C.M. Skene (partial attendance) — Code Investigation
M.L. Sigurdson — Code Investigation
R.M. Carter Prévost — Code Investigation
J.T. Eamon — Code Investigation
J.B. Champion — S.W. Johnson et al
J.P. Warner — S.W. Johnson et al
W. S. McKall (partial attendance) — Government of Alberta
Bev Behan — Government of Alberta
K.J. Chapman — Ken Marlin
C.K.W. Thietke — Investors' Counsel
J.G. McNiven — Investors' Counsel
R.B. White, Q.C. — Investors' Counsel
Mr. Shaw — Investors' Counsel
B. Lester — Collins Barrow
B.M. Heck — Donald Cormie
W.J. Kenny — Donald Cormie

1. Wittmann advised that in response to the letter dated August 18, 1988 regarding the proposed procedure for allowing parties notice of allegations, he had received responses from a number of people. He described the response of Mr. Kenny, which he stated was more or less illustrative of the position of the parties. The response could be summarized as a discussion of administrative law and the requirements of natural justice, a requirement that notice of allegations be given and requirement that such notices be private.

   Wittmann stated it seemed to him that there would be no agreement amongst the counsel and accordingly, someone would have to make a motion. Wittmann stated that he would make a motion if nobody else did.

   Mr. Kenny stated, and Mr. White agreed, that insofar as the parties had their positions, there was no use discussing it further within the context of a counsel meeting and the positions would be made at the application. Mr. Warner agreed.

   There was some discussion as to the merits of the matter between Wittmann and Chapman.

   Warner inquired whether any other party had raised whether or not the argument should be in private. Eamon stated that Sharon Harper had raised the matter. After some discussion, the consensus apparently reached was that insofar as there was a good argument that the Inspector was bound to hear argument in public, it would not be appropriate for the Inspector to make the application as to whether the argument should be in private. Wittmann stated that he would like that application to be heard on the same date.

   Parties were to check whether they would be available for an application a week this Friday, and would advise this evening or tomorrow morning.

2. The matter of witness scheduling was discussed.

   Wittmann also stated that if a party wished to recall his own client, as opposed to other witnesses, that party would be entitled to lead his or her client. If Wittmann wished to recall the client, Wittmann would lead. If both Wittmann and counsel wished to recall a client, the matter would be discussed between them. As for other witnesses, Wittmann reiterated that if a party wants such witnesses called, he should advise Wittmann, and Wittmann would lead the evidence. This did not apply in the case of experts. Where a party wishes to call his or her own expert, they may lead that witness.

3. Wittmann described briefly that a stock market expert would be called, followed by experts from Clarkson Gordon who would testify as to the causes of failure of the contract companies and as to accounting standards. Wittmann stated that he was toying with the idea of calling somebody to speak on the matter of the real estate collapse.

The meeting adjourned.

CODE INVESTIGATION

MINUTES OF COUNSEL MEETING

No. 8

(Wednesday, November 23, 1988)

PRESENT: N.C. Wittmann, Q.C. — Code Investigation
Catherine M. Skene — Code Investigation
Maryn Sigurdson — Code Investigation
Rose M. Carter Prévost — Code Investigation
Linda Taylor — Code Investigation
Dave Poulton — Code Investigation
Jim Eamon — Code Investigation
Jeff B. Champion — S.W. Johnson et al
J.P. Warner — S.W. Johnson et al
Ted Feehan — Government of Alberta
Ken J. Chapman — Ken Marlin
Clause Thietke — Investors' Counsel
John G. McNiven — Investors' Counsel
R.B. White, Q.C. — Investors' Counsel
Kent Davidson — Investors' Counsel
Brian Lester — Collins Barrow
Bill Kenny — Donald Cormie et al
B.F. Hughson — Tewfik Saleh
Barry Zalmanowitz — Watt, Levesque Beaubien
Joe Kueber — Coopers & Lybrand
James A. Wachowich — Jude Halvorson
Sherry Harper — Christa U. Petracca
Graham McLennan — Deloitte Haskins & Sells

Wittmann chaired the meeting. He indicated that the purpose of the meeting according to the agenda consisted of the remaining witnesses, argument and submissions and the appeal of Mr. Justice Berger's decision on notice/procedure.

1. Remaining Witnesses

After some discussion, the deadline for remaining witnesses was confirmed as the close of business, Thursday, November 24, 1988, after which Wittmann would, as best he could, schedule any person that wanted to be recalled. McNiven presented two documents, one a proposed statutory declaration by John Ryan of Coopers & Lybrand and the other a schedule of mortgages/real property. The proposition was that the schedules/statutory declaration go in by consent and some deadlines were set to notify Wittmann as to whether or not consent was achieved or achievable, namely 10:00 a.m., November 28, 1988 for the statutory declaration and 10:00 a.m., November 29, 1988 for the mortgage schedule. Wittmann confirmed that Marlin was coming back, that a sales person would be called due to new evidence presented and that new information coming to Wittmann and Duke that indicated that he was going to call his chartered accountant expert on December 1, 1988.

2. Appeal — Notice/Procedure

Wittmann indicated that he had filed a Notice of Appeal and there was some discussion as to whether a compromise could be reached. It was decided that no such compromise could be readily ascertained, but that everyone was willing to talk. After some further discussion, Wittmann indicated that he had telephoned the Registrar of the Court of Appeal, that he had received a return phone call from Justice Kerans, and later Justice McClung, who indicated the appeal would commence at 10:00 a.m., Wednesday, November 30, 1988. Wittmann made a proposal for the contents of the Appeal Book and indicated he was going to advise the court of the proposal as he wouldn't have time to circulate a formal agreement. Everyone seemed to agree that that was satisfactory, provided they had a later opportunity to add material in the event it was missed. That procedure was agreed to be followed and Wittmann indicated that the Appeal Book and the Factum of the Inspector would be filed no later than Friday, November 25, 1988. If anyone had a cross-appeal on the issue of notice at large, they were to include it and Wittmann indicated he would notify that he anticipated a cross-appeal.

3. **Argument/Submission**

The minutes of a previous meeting, May 24, 1988, were referred to as to the agreed upon timing and procedure for submissions and arguments. It was decided that the general consensus was that what had been tentatively put forward on previous occasions was unworkable due to the sheer volume of evidence. After much discussion, all counsel decided upon the following method and timing of presentation for written and oral argument:

1. There should be 45-60 days from the close of the evidence until the date of the presentation of written argument. Wittmann indicated he would take the matter up with Mr. Code to see what time frame Mr. Code would accommodate. White and Kenny made it clear that anything less than 45 days would result in their making an application before Mr. Justice Berger for additional time.
2. Written argument will be submitted by all parties who wish to submit written argument on the date directed selected for the submission.
3. Oral argument will follow the submission of written argument. It was the consensus that there may not be a great time lag between the filing of written argument and the commencement of oral argument and that a weekend would be quite satisfactory, in other words, two clear days.

4. **Order of Presentation of Oral Argument**

The fine details of presentation were not discussed, but generally speaking, it was the consensus that the investors ought to be able to go first and that the Cormie family ought to be last. Wittmann indicated he would draw up a schedule of the presentation for oral argument for circulation and that is done and is attached as Schedule "A" to these minutes.

5. Everyone was canvassed as to whether or it would be realistic and proper to put a time limit on oral argument. There was consensus to the time limit with an order, but some reservation as to Mr. Code[']s questions, if any, as affecting as time frame. White indicated he would be hour or less. [McNiven] indicated he would also be one hour or less. Kenny indicated that he would be two hours or less and everyone else seemed to agree with the two hour or less time frame. That being the case, oral argument will proceed on the basis that the maximum time for a verbal submission is two hours, barring any protracted questions and answers which at the discretion of the Inspector could result in an extension of time.

6. Seven days after the conclusion of oral argument, written rebuttal arguments, if any, are due. Thus the meeting concluded on the basis that the crucial outstanding item was the length of time that the Inspector would rule would be available for the commencement of argument. As it was apparent that the evidence would likely wrap up during the week of December 5, 1988, at the latest, Wittmann indicated that Mr. Code would likely set a date certain for the commencement of oral argument and the submission of written argument. There was some grumbling about that

on that basis that it should be a certain number of days after the conclusion of the evidence, but most people were in agreement that the evidence hereafter would not significantly affect the preparation of written argument.

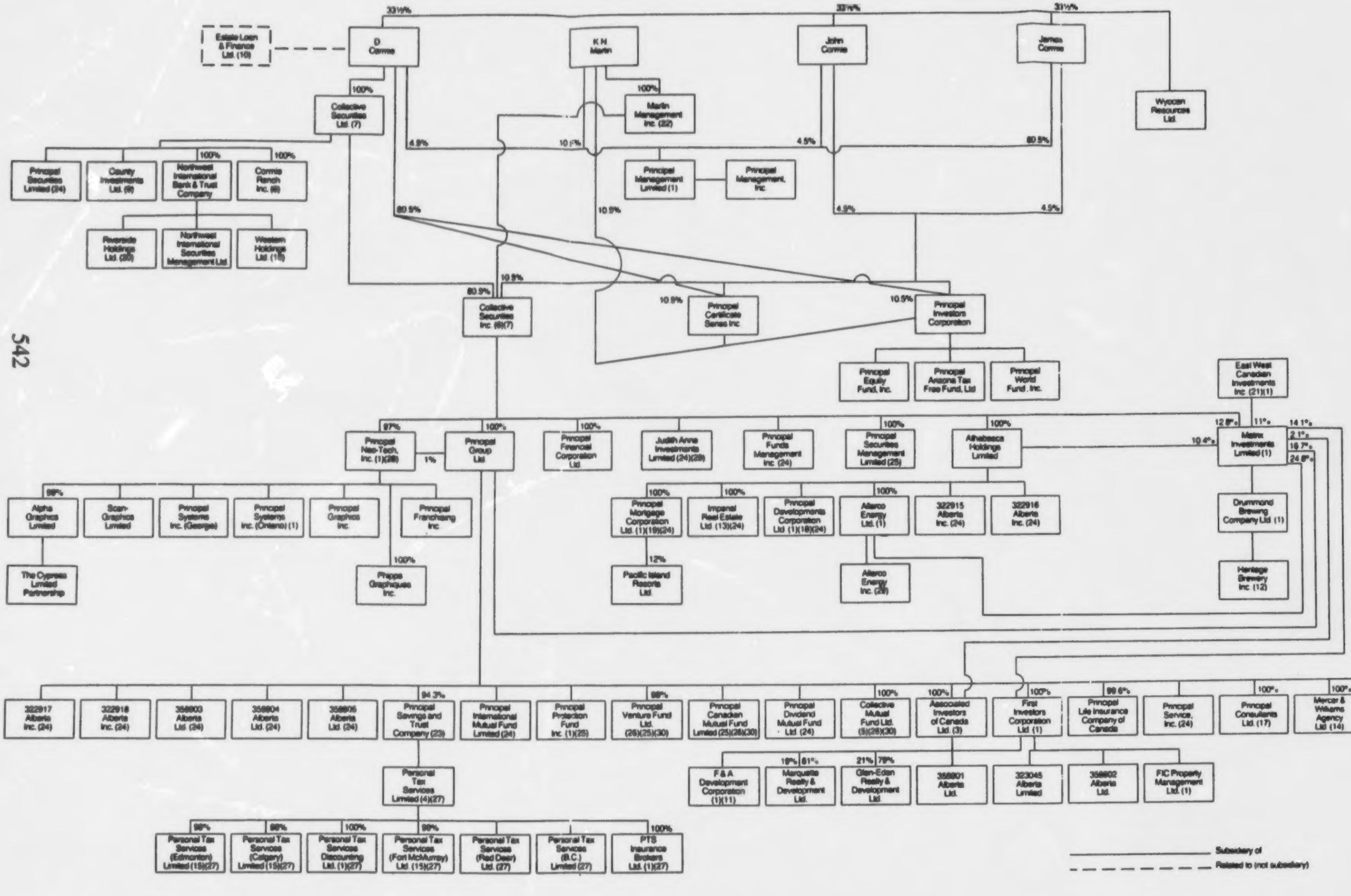
SCHEDULE "A"

Order of Presentation of Oral Argument — 2 hour time limit:

1. Investors — Northern Alberta and B.C.
2. Investors — Southern Alberta and points east
3. Liquidator, PST
4. Coopers & Lybrand
5. Collins Barrow
6. Government of B.C.
7. Jim Darwish
8. Tewfik Saleh
9. Government of Alberta
10. Grant Mitchell
11. The VPs/Nicholson
12. Christa Petracca
13. Ken Marlin
14. Touche Ross
15. Deloitte, Haskins & Sells
16. Jude Halvorson
17. Eric Espenberg
18. John Cormie, James Cormie, Don Cormie

SCHEDULE C

THE PRINCIPAL GROUP CORPORATE CHART AS AT JUNE 30, 1987 (2)


33⅓%
33⅓%
33⅓%
Estate Loan & Finance Ltd. (10)
D Cormie
K N Martin
John Cormie
James Cormie
Wyocan Resources Ltd.
100%
Collective Securities Ltd. (7)
100%
Martin Management Inc. (22)
4.8%
10.1%
4.5%
80.9%
Principal Management Limited (1)
Principal Management, Inc.
100%
100%
Principal Securities Limited (24)
County Investments Ltd. (9)
Northwest International Bank & Trust Company
Cormie Ranch Inc. (8)
Riverside Holdings Ltd. (20)
Northwest International Securities Management Ltd
Western Holdings Ltd. (16)
80.9%
10.9%
4.5%
4.5%
10.9%
80.9%
10.9%
10.5%
Collective Securities Inc. (6)(7)
Principal Certificate Series Inc
Principal Investors Corporation
Principal Equity Fund, Inc.
Principal Arizona Tax Free Fund, Ltd
Principal World Fund, Inc.
East West Canadian Investments Inc (21)(1)
97%
100%
100%
100%
100%
12.8%
11%
14.1%
2.1%
16.7%
24.8%
10.4%
Principal Neo-Tech, Inc. (1)(28)
1%
Principal Group Ltd
Principal Financial Corporation Ltd
Judith Anne Investments Limited (24)(29)
Principal Funds Management Inc. (24)
Principal Securities Management Limited (25)
Athabasca Holdings Limited
Matrix Investments Limited (1)
98%
Alpha Graphics Limited
Scan-Graphics Limited
Principal Systems Inc. (George)
Principal Systems Inc. (Ontario) (1)
Principal Graphics Inc.
Principal Franchising Inc
100%
100%
100%
100%
Principal Mortgage Corporation Ltd. (1)(19)(24)
Imperial Real Estate Ltd (13)(24)
Principal Developments Corporation Ltd (1)(18)(24)
Alberco Energy Ltd. (1)
322915 Alberta Inc. (24)
322916 Alberta Inc. (24)
Drummond Brewing Company Ltd (1)
The Cypress Limited Partnership
100%
Phipps Graphiques Inc.
12%
Pacific Island Resorts Ltd.
Alberco Energy Inc. (28)
Heritage Brewery Inc (12)
94.3%
98%
100%
100%
100%
99.6%
100%
100%
322917 Alberta Inc. (24)
322918 Alberta Inc. (24)
358803 Alberta Ltd. (24)
358804 Alberta Ltd. (24)
358805 Alberta Ltd. (24)
Principal Savings and Trust Company (23)
Principal International Mutual Fund Limited (24)
Principal Protection Fund Inc. (1)(25)
Principal Venture Fund Ltd. (26)(25)(30)
Principal Canadian Mutual Fund Limited (25)(26)(30)
Principal Dividend Mutual Fund Ltd. (24)
Collective Mutual Fund Ltd. (5)(26)(30)
Associated Investors of Canada Ltd. (3)
First Investors Corporation Ltd. (1)
Principal Life Insurance Company of Canada
Principal Service, Inc. (24)
Principal Consultants Ltd. (17)
Mercer & Williams Agency Ltd (14)
Rocky Mountain Brewing (1986) Corporation (1)
Personal Tax Services Limited (4)(27)
19%
81%
21%
79%
F & A Development Corporation (1)(11)
Marquette Realty & Development Ltd.
Glen-Eden Realty & Development Ltd.
358801 Alberta Ltd.
323045 Alberta Limited
358802 Alberta Ltd.
FIC Property Management Ltd. (1)
98%
98%
100%
98%
100%
Personal Tax Services (Edmonton) Limited (15)(27)
Personal Tax Services (Calgary) Limited (15)(27)
Personal Tax Services Discounting Ltd. (1)(27)
Personal Tax Services (Fort McMurray) Ltd. (15)(27)
Personal Tax Services (Red Deer) Ltd. (27)
Personal Tax Services (B.C.) Limited (27)
PTS Insurance Brokers Ltd. (1)(27)
Subsidiary of
Related to (not subsidiary)

SCHEDULE D

SUMMARY OF DIRECTORS OF CERTAIN COMPANIES

(From 1980 to May, 1987 — Where available)

Company	Date	Directors
PGL	1980-1987	Cormie, Donald M. Marlin, Kenneth N. Cormie, John M. Cormie, James M.
FIC	1985-1987	Marlin, Kenneth N. Espenberg, Eric J. Petracca, Christa U. (appointed March 27, 1985)
	1980-1984	Marlin, Kenneth N. Espenberg, Eric J.
AIC	1985-1987	Marlin, Kenneth N. Espenberg, Eric J. Petracca, Christa U. (appointed March 27, 1985)
	1980-1984	Marlin, Kenneth N. Espenberg, Eric J.
PS&T[1]	1987	Cormie, Donald M. Cormie, John M. Petracca, Christa U. Smith, Adeline N. Pearce, Robert G. Aboussafy, George Cormie, Allison B. Marlin, Kenneth N.
	1986	Cormie, Donald M. Cormie, John M. Petracca, Christa U. Smith, Adeline N. Cormie, Allison B. Marlin, Kenneth N. Abousaffy, George Pearce, Robert G. Mitchell, D. Grant (resigned July 23, 1986)
	1985	Cormie, Donald M. Cormie, John M. Petracca, Christa U. Smith, Adeline N. Mitchell, D. Grant Abousaffy, George Cormie, Allison B. Marlin, Kenneth N.

Company	Date	Directors
	1984	Cormie, Donald M.
		Cormie, John M.
		Petracca, Christa U.
		Smith, Adeline N.
		Mitchell, D. Grant
		Coutts, William
		Cormie, Allison B.
		Marlin, Kenneth M.
PCL[2]	1986-1987	Moulton, Hugh James
		Marlin, Kenneth N.
		Gilhooly, James G.
		Mitchell, D. Grant (resigned July 23, 1986)
	1984-1985	Marlin, Kenneth N.
		Gilhooly, James G.
		Mitchell, D. Grant
	1983	Marlin, Kenneth N.
		Gilhooly, James G.
		Mitchell, D. Grant (appointed June 28, 1983)
		Hickey, John P. Jr.
	1981-1982	Marlin, Kenneth N.
		Gilhooly, James G.
		Hickey, John P. Jr.
CSI[3]	1985-1987	Cormie, Donald M.
		Marlin, Kenneth N.
		Cormie, James M.
		Cormie, John M.
CSL	1986-1987	Cormie, Donald M.
		Cormie, James M.
	1980-1985	Cormie, Donald M.
		Cormie, James M.
		Cormie, John M. (resigned December 18, 1985)
		Marlin, Kenneth N. (resigned December 18, 1985)
AHL[4]	1981-1987	Cormie, Donald M.
		Petracca, Christa U.
PNI[5]	1987	Brent, Peter E.
		Cormie, John M.
		Gordon, Lloyd L.
		Marlin, Kenneth N.
		McIntyre, Andrew A.
		Nicholson, Virginia S.
		Patrick, Lynn A.
		Renahan, James P.
		Zilli, David A.

Company	**Date**	**Directors**
	1985-1986	Brent, Peter E.
		Cormie, John M.
		Gordon, Lloyd L.
		Keedwell, Douglas R.
		Leith, Ian Q.
		Lillico, Adrian W.
		Marlin, Kenneth N.
		McIntyre, Andrew A.
		Nicholson, Virginia S.
		Patrick, Lynn A.
	1984	Cormie, John M.
		Brent, Peter E.
		Keedwell, Douglas R.
		Leith, Ian Q.
		Lillico, Adrian W.
		Marlin, Kenneth M.
		McIntyre, Andrew A.
		Nicholson, Virginia S.
		Patrick, Lynn A.
Matrix	1987	Cormie, Neil B.
		Cormie, Donald M.
		Cormie, James M.
		Petracca, Christa U.
		Lefaivre, Paul W.
		Cochrane, Kenneth
		Pearce, Robert G.
		Baker, John E.
		Finlay, David G. (appointed April 6, 1987)
	1986	Cormie, Neil B. (appointed February 12, 1986)
		Cormie, Donald M.
		Cormie, James M.
		Petracca, Christa U.
		Lefaivre, Paul W.
		Cochrane, Kenneth
		Pearce, Robert G.
		Beaudry, Emile L. (resigned July 14, 1986)
		Hipple, Gerald (resigned January 15, 1986)
Matrix[7] Exploration Ltd.	1985	Cormie, Donald M.
		Cormie, James M.
		Petracca, Christa U.
		Beaudry, Emile L.
		Cochrane, Kenneth
		Lefaivre, Paul W. (appointed November 12, 1985)
		Roozen, Harold A. (resigned November 18, 1985)
		Hipple, Gerald

Company	Date	Directors
	1984	Cormie, Donald M. Cormie, James M. Petracca, Christa U. Beaudry, Emile L. Cochrane, Kenneth Roozen, Harold A. Hipple, Gerald Macateer, Paul (appointed June 26, 1984) Allard, Charles A. (resigned June 26, 1984)
CIL	1987	Halvorson, Judith L. Lindsay, Heather Beaton, Cynthia
	1986	Halvorson, Judith L. Lindsay, Heather
	1985	Halvorson, Judith L. Lindsay, Heather McMullen, Vivian Ryan, Sharon
	1983-1984	Halvorson, Judith L. McMullen, Vivian
	1982	Halvorson, Judith L. McMullen, Vivian Langston, Robert D.
	1981	Halvorson, Judith L. Langston, Robert D. McEwen, Patricia
	1980	Langston, Robert D. McEwen, Patricia
EL&F[6]	1985-1987	Halvorson, Judith L. Stefanski, Diane R.
	1984	Halvorson, Judith L. Stefanski, Diane R. Langston, Robert D.

1. Directorships before 1984 not in evidence.
2. Directorships for 1980 not in evidence.
3. Incorporated December 18, 1985.
4. Directorships for 1980 not in evidence.
5. PNI acquired by PGL in September, 1983.
6. Directorships for 1980 — 1983 not in evidence.
7. In fact, this is the same company as Matrix. Name was changed to Matrix Investments Limited in late 1985.

SCHEDULE E

FIRST INVESTORS CORPORATIONS LTD.

ANALYSIS OF CERTIFICATE LIABILITIES
(000's)

Year	Installment Certificate	Single Payment Certificate	Total	Total Certificate Liabilities % Increase/(Decrease) From Prior Year
1986 (1)	$17,257	$297,924	$315,181	0.94%
	5.5%	94.5%	100.0%	
1985	$18,785	$293,456	$312,241	2.0%
	6.0%	94.0%	100.0%	
1984	$20,188	$286,063	$306,251	24.6%
	6.6%	93.4%	100.0%	
1983	$20,506	$225,234	$245,740	8.1%
	8.3%	91.7%	100.0%	
1982	$20,486	$206,738	$227,224	39.6%
	9.0%	91.0%	100.0%	
1981	$23,304	$139,456	$162,760	31.9%
	14.3%	85.7%	100.0%	
1980	$25,490	$ 97,945	$123,435	37.6%
	20.7%	79.3%	100.0%	
1979	$26,047	$ 63,630	$ 89,677	35.2%
	29.0%	71.0%	100.0%	
1978	$25,964	$ 40,369	$ 66,333	33.3%
	39.1%	60.9%	100.0%	
1977	$25,588	$ 24,191	$ 49,779	3.7%
	51.4%	48.6%	100.0%	
1976	$25,741	$ 22,253	$ 47,994	6.5%
	53.6%	46.4%	100.0%	
1975	$25,462	$ 19,596	$ 45,058	6.0%
	56.5%	43.5%	100.0%	
1974	$24,629	$ 17,860	$ 42,489	9.2%
	58.0%	42.0%	100.0%	
1973	$23,996	$ 14,929	$ 38,925	N/A
	61.6%	38.4%	100.0%	

Source: Audited Financial Statements (Draft 1986) — Exhibit 272 and Exhibit 548; Exhibit 606, Schedule 10.

(1) In all years except 1986, additional credits were included in the certificate liability balance which was disclosed on the financial statements. In 1986, the draft financial statement presentation changed and additional credits of $23,677,000 were disclosed separately and not allocated to the certificate liability balances. For the purpose of this schedule Woods Gordon prorated the 1986 additional credits to the installment certificate and single payment certificate balances based upon the relative balance outstanding.

ASSOCIATED INVESTORS OF CANADA LTD.

ANALYSIS OF CERTIFICATE LIABILITIES

($000)

Year	Installment Certificates	Single Payment Certificates	Total	Total Certificate Liabilities % Increase/(Decrease) From Prior Year
1986 (1)	$ 1,812	$124,548	$126,360	32.3%
	1.4%	98.6%	100.0%	
1985	$ 1,946	$ 93,573	$ 95,519	8.4%
	2.0%	98.0%	100.0%	
1984	$ 2,299	$ 85,836	$ 88,135	5.7%
	2.6%	97.4%	100.0%	
1983	$ 2,811	$ 80,577	$ 83,388	18.5%
	3.4%	96.6%	100.0%	
1982	$ 3,303	$ 67,047	$ 70,350	27.2%
	4.7%	95.3%	100.0%	
1981	$ 4,268	$ 51,044	$ 55,312	19.4%
	7.7%	92.3%	100.0%	
1980	$ 5,585	$ 40,727	$ 46,312	50.0%
	12.1%	87.9%	100.0%	
1979	$ 6,341	$ 24,545	$ 30,886	50.9%
	20.5%	79.5%	100.0%	
1978	$ 6,521	$ 13,951	$ 20,472	48.7%
	31.8%	68.2%	100.0%	
1977	$ 7,292	$ 6,479	$ 13,771	2.8%
	52.9%	47.1%	100.0%	
1976	$ 7,919	$ 5,476	$ 13,395	(8.6%)
	59.1%	40.9%	100.0%	
1975	$ 8,791	$ 5,870	$ 14,661	(6.3%)
	60.0%	40.0%	100.0%	
1974	$ 9,370	$ 6,274	$ 15,644	(5.3%)
	60.0%	40.0%	100.0%	
1973	$10,067	$ 6,454	$ 16,521	N/A
	60.9%	39.1%	100.0%	

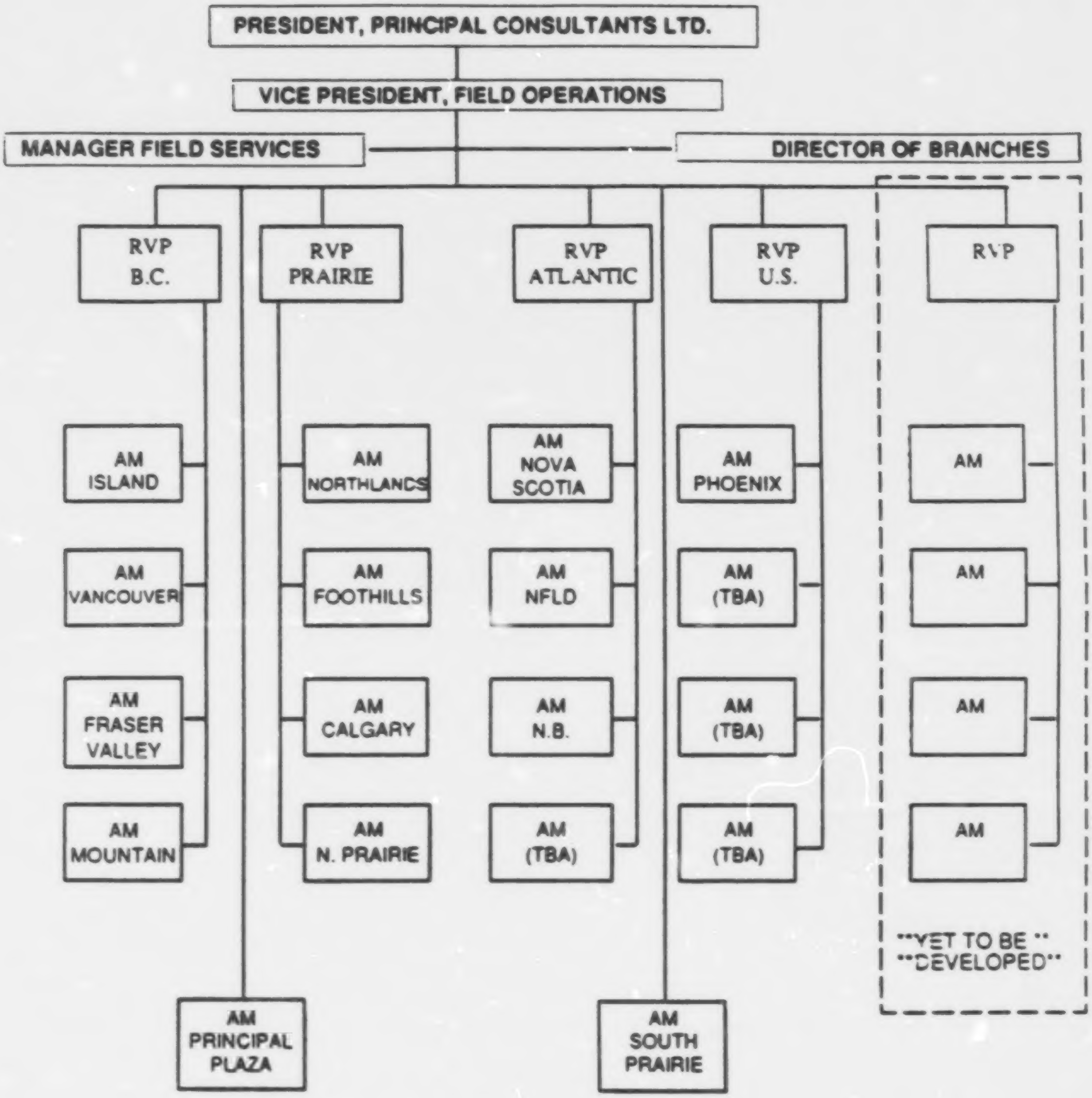
Source: Audited Financial Statements (Draft 1986) — Exhibits 273 and 549; Exhibit 607, Schedule 10.

(1) In all years except 1986, additional credits were included in the certificate liability balance which was disclosed on the financial statements. In 1986, the draft financial statement presentation changed and additional credits of $6,592,000 were disclosed separately and not allocated to the certificate liability balance. For the purpose of this schedule Woods Gordon prorated the 1986 addi tional credits to the installment certificate and single payment certificate balances based upon the relative balance outstanding.

SCHEDULE F

FIELD ORGANIZATION AND OPERATION

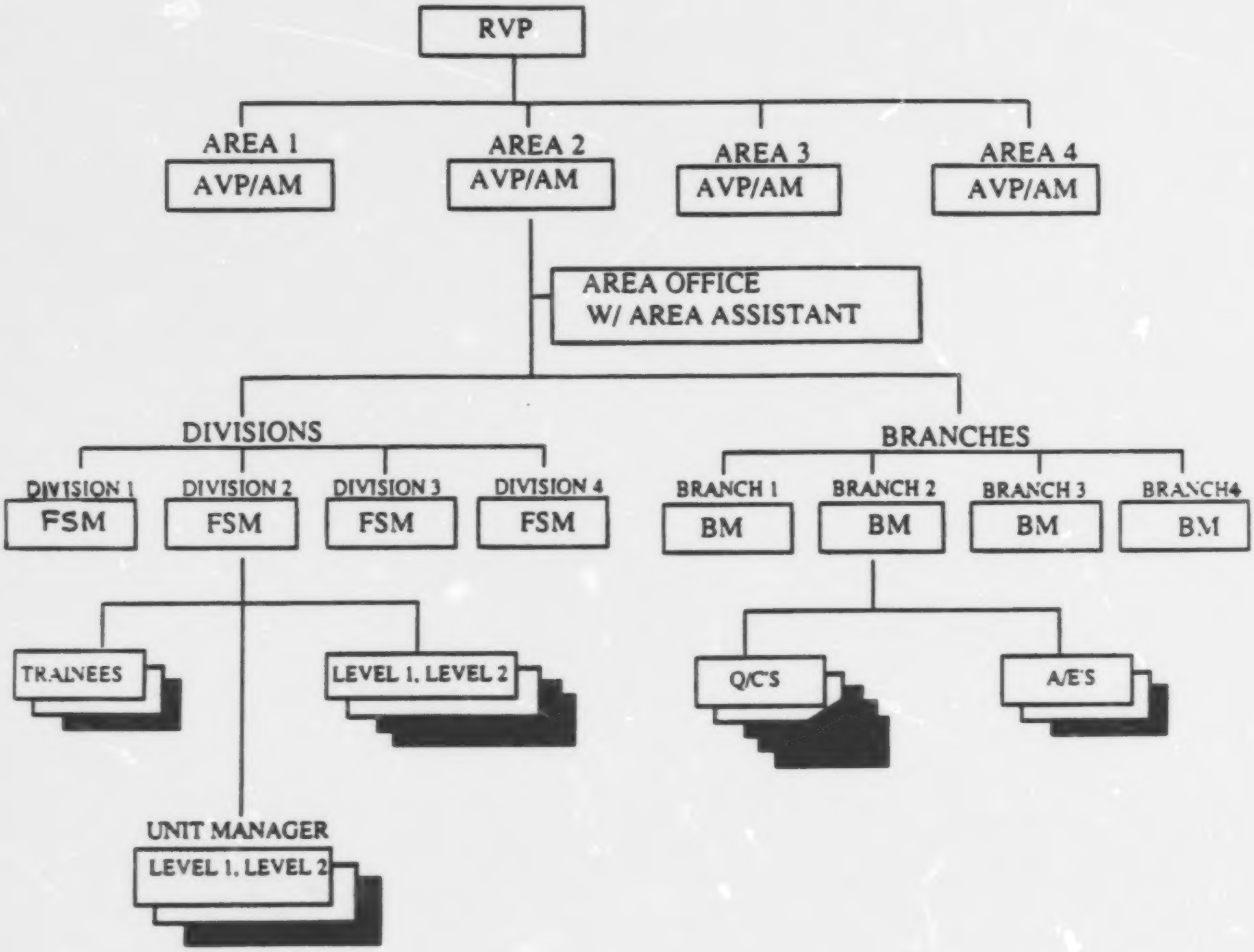
PCL ORGANIZATION CHART


PRESIDENT, PRINCIPAL CONSULTANTS LTD.
VICE PRESIDENT, FIELD OPERATIONS
MANAGER FIELD SERVICES
DIRECTOR OF BRANCHES
RVP B.C.
RVP PRAIRIE
RVP ATLANTIC
RVP U.S.
RVP
AM ISLAND
AM VANCOUVER
AM FRASER VALLEY
AM MOUNTAIN
AM NORTHLANDS
AM FOOTHILLS
AM CALGARY
AM N. PRAIRIE
AM NOVA SCOTIA
AM NFLD
AM N.B.
AM (TBA)
AM PHOENIX
AM (TBA)
AM (TBA)
AM (TBA)
AM
AM
AM
AM
"YET TO BE" "DEVELOPED"
AM PRINCIPAL PLAZA
AM SOUTH PRAIRIE

SCHEDULE G

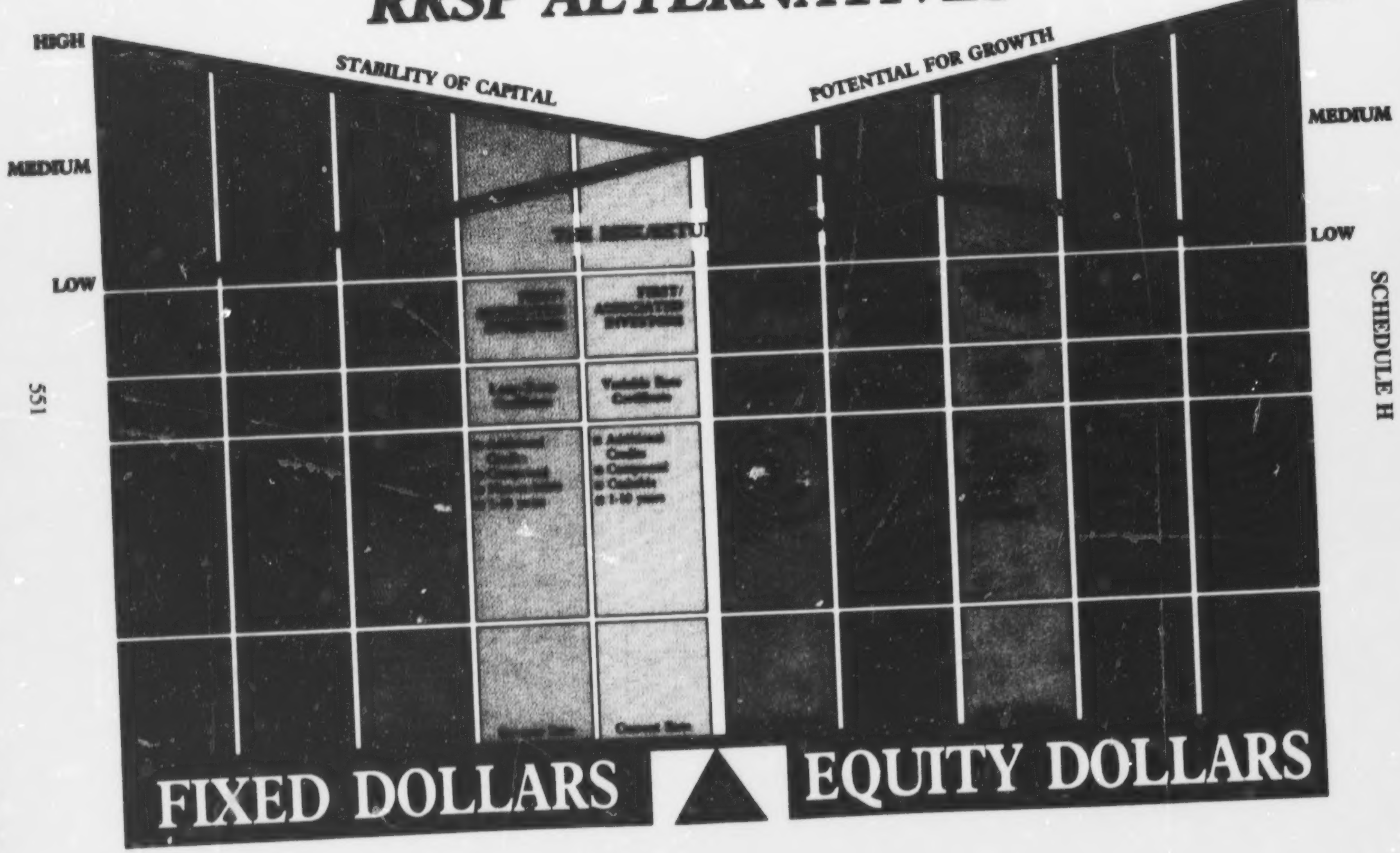
FIELD ORGANIZATION AND OPERATION

TYPICAL REGIONAL ORGANIZATIONAL CHART


RVP
AREA 1
AVP/AM
AREA 2
AVP/AM
AREA 3
AVP/AM
AREA 4
AVP/AM
AREA OFFICE W/ AREA ASSISTANT
DIVISIONS
BRANCHES
DIVISION 1
FSM
DIVISION 2
FSM
DIVISION 3
FSM
DIVISION 4
FSM
BRANCH 1
BM
BRANCH 2
BM
BRANCH 3
BM
BRANCH4
BM
TRAINEES
LEVEL 1, LEVEL 2
Q/C'S
A/E'S
UNIT MANAGER
LEVEL 1, LEVEL 2

SCHEDULE H

PRINCIPAL RRSP ALTERNATIVES


HIGH
MEDIUM
LOW
STABILITY OF CAPITAL
POTENTIAL FOR GROWTH
HIGH
MEDIUM
LOW
FIXED DOLLARS
EQUITY DOLLARS

SCHEDULE I

TABLE OF DEPOSITORS' PROTECTION

DEPOSIT-TAKING INSTITUTIONS	Specified Investments	Capital Ratio Requirement	Custodian-Held Assets	Assumed-Rate Reserve	Qualified Investment Under Canadian & British Act	Canadian deposit Insurance Corporation	Special Insurance Fund*
Trust Co. & Loan Co.	X	X			X	X	
Banks	X	X			X	X	
Investment Contract Co.	X	X	X	X	X		
Credit Union	X	X					X
Life Insurance Co.	X			X			
Qualified Financial Co.		X			X		
Mutual Funds	X		X				
Non-Regulated Investment Co.							
*Subject to certain Limitations							

SCHEDULE J

PRINCIPAL GROUP LTD.
(for internal use only Head Office)

Rate Sheet

NUMBER: 2151

ISSUED BY: Sales Committee
EFFECTIVE DATE: May 22, 1987
REPLACES SHEET DATED: May 6, 1987
(i.e. 3:00 p.m. May 21, 1987)

PRINCIPAL TRUST

TERM		INTEREST PAYABLE	GUARANTEED RATE
30	MAT	N/A	NONE
60	MAT		
90	MAT		
180	MAT		
270	MAT		
12 months	MON	(TNMMS)	7.50
	ANN	(TNAAS)	8.00
	MAT	(TNTAC)	8.00
	RRSP	(TRTAC)	8.00
18 months	MAT	(TNTAC)	8.50
	RRSP***	(TRTAC)	8.50
24 months	MON	(TNMMS)	9.00
	ANN	(TNAAS)	9.50
	MAT	(TNTAC)	9.00
	RRSP-C	(TRTAC)	9.00
	RRSP-S	(TRAAS)	9.50
36 months	MON	(TNMMS)	8.50
	ANN	(TNAAS)	9.00
	MAT	(TNTAC)	8.50
	RRSP-C	(TRTAC)	8.50
	RRSP-S	(TRAAS)	9.00
48 months	MON	(TNMMS)	8.50
	ANN	(TNAAS)	9.00
	MAT	(TNTAC)	8.50
	RRSP-C	(TRTAC)	8.50
	RRSP-S	(TRAAS)	9.00
60 months	MON	(TNMMS)	9.00
	ANN	(TNAAS)	9.50
	MAT	(TNTAC)	9.00
	RRSP-C	(TRTAC)	9.00
	RRSP-S	(TRAAS)	9.50
72 to 120 months	MON	N/A	NONE
	ANN		
	MAT		
	RRSP		

FIC/AIC (Add'l Credit Term Certificates)

TERM		INTEREST PAYABLE	4% + CURRENT ADD'L CREDIT		CURRENT** EPP. YIELD
3 MO	MAT	(TNTTS)	GUARANTEED	=	7.00
6 MO	MAT	(TNTTS)	GUARANTEED	=	7.75
9 MO	MAT	(TNTTS)	GUARANTEED	=	8.00
364 DAY	MAT		GUARANTEED	=	8.25
12 months	MON	(TNMMS)	4.00	=	8.00
	ANN	(TNAAS)	--	=	--
	MAT	(TNTAC)	4.50	=	8.50
	RRSP	(TRTAC)	4.50	=	8.50
18 months	MAT	(TNTAC)	5.00	=	9.00
	RRSP***	(TRTAC)	5.00	=	9.00
24 months	MON	(TNMMS)	5.50	=	9.50
	ANN	(TNAAS)	6.00	=	10.00
	MAT	(TNTAC)	5.50	=	9.50
	RRSP-C	(TRTAC)	5.50	=	9.50
36 months	MON	(TNMMS)	5.00	=	9.00
	ANN	(TNAAS)	5.50	=	9.50
	MAT	(TNTAC)	5.00	=	9.00
	RRSP-C	(TRTAC)	5.00	=	9.00
48 months	MON	(TNMMS)	5.00	=	9.00
	ANN	(TNAAS)	5.50	=	9.50
	MAT	(TNTAC)	5.00	=	9.00
	RRSP-C	(TRTAC)	5.00	=	9.00
60 months	MON	(TNMMS)	5.50	=	9.50
	ANN	(TNAAS)	6.00	=	10.00
	MAT	(TNTAC)	5.50	=	9.50
	RRSP-C	(TRTAC)	5.50	=	9.50
72 to 120 months	MON	(TNMMS)	4.50	=	8.50
	ANN	(TNAAS)	5.00	=	9.00
	MAT	(TNTAC)	4.50	=	8.50
	RRSP-C	(TRTAC)	4.50	=	8.50

NOTE: ¼% higher on amounts of $200,000 (1-5 year) for FIC/AIC.

C = Compound
S = Safeguard

PGL CORPORATE NOTES

Rates Subject to Head Office Approval	TERM	INTEREST PAYABLE
7.75		30 - 59
8.00		60 - 89
8.00		90 - 179
8.25		180 - 269
8.50		270 - 364
8.75	12 months	MON
--		ANN
9.25		MAT
9.00	18 months	MON
9.50		ANN
9.50		MAT***
9.75	24 months	MON
10.25		ANN
9.75		MAT
9.50	36 months	MON
10.00		ANN
9.50		MAT
9.50	48 months	MON
10.00		ANN
9.50		MAT
10.00	60 months	MON
10.50		ANN
10.00		MAT

Special 1 year PGL Note callable after 30 days with 30 days written notice @ 8% otherwise 9% flat rate.

NOTE:
¼% higher on amounts of $200,000
(1-5 yr.)

FIC MATURITIES REINVEST INTO FIC.
AIC MATURITIES REINVEST INTO AIC.
ALL NEW MONEY -- FIC

PRINCIPAL TRUST

OTHER PRODUCTS		Guaranteed Rate
U.S. Dollar A/C Rate		3.50
Guaranteed RRSP	Calculated Daily Paid S/A	4.25
Prime Savings Account		
Over $ 3,000 = 4.25	Amounts Under $ 3,000 =	3.50
TMS Chequing		
Over $15,000 = 5.00	Amounts Under $15,000 =	4.00
	Calculated Daily Paid S/A	
Platinum 55+		4.50
Principal Commercial Account (No Min. OFP)		3.00
Loans: Individual Current Rate (3½% above prime)		
Business Current Rate (3½% above prime)		
Loan Limit: Mutual Funds		70%
Terms		70%
Per annum compounded monthly:		13.00*
Monthly:		1.08*
Effective rate/annum.		13.80*

Remarks:
* Designates rate changed from last rate sheet.
** Current effective yields assume the current additional credits will be paid annually to maturity.
*** Compounded annually to maturity.

Minimum Investments:

- $ 500.00 on FIC/AIC all terms (30 days & over) / ($3,000.00 - monthly interest)
- $1,000.00 on all PST terms (1 yr. & over) / $3,000.00 - monthly interest)
- $ 600.00 for single pay mutual funds and $100 minimum for subsequent deposits.

Term Deposits / Certificates commence on the date (prior to 3:00 p.m.) they are received in a PFC. Absolutely no backdating.

NOTE: PS&T Safeguard option pays annual interest to GRSP.
Source: [Exhibit 227 at 15-16]. Re-typed from the original without correction of any typographical errors.

PRINCIPAL GROUP LTD.
(for internal use only)

Rate Sheet

NUMBER 2151

ISSUED BY: Terry Pejnovic: Sales Committee
EFFECTIVE DATE: May 22, 1987
REPLACES SHEET DATED: May 6, 1987
(i.e. 3:00 p.m. May 21, 1987)

FIC/AIC SAFEGUARD OPTION

TERM		INTEREST PAYABLE	4%+CURRENT ADD'L CREDIT		CURRENT** EFF. YIELD
3 MO 6 MO 9 MO			NONE		
12 months		NONE			
18 months		NONE			
24 months	ANN	(VNTSG)	6.00	=	10.00
	RRSP-A	(VRTSG)	6.00	=	10.00
36 months	ANN	(VNTSG)	5.50	=	9.50
	RRSP-A	(VRTSG)	5.50	=	9.50
48 months	ANN	(VNTSG)	5.50	=	9.50
	RRSP-A	(VRTSG)	5.50	=	9.50
60 months	ANN	(VNTSG)	6.00	=	10.00
	RRSP-A	(VRTSG)	6.00	=	10.00
72 to 120 months	ANN	(VNTSG)	5.00	=	9.00
	RRSP-A	(VRTSG)	5.00	=	9.00

NOTE: ¼ % higher on amounts of $200,000 (1 - 5 year) for FIC / AIC.

FIC/AIC Safeguard Option Savings

Interest Rate:

ANN		(VNTSI)	7.00
RRSP	ANN	(VRTSI)	7.00

Remarks:
* Designates rate changed from last rate sheet.
** Current effective yields assume the current additional credits will be paid annually to maturity.
*** Compounded annually to maturity.

Source: [Exhibit 227 at 15-16]. Re-typed from the original without correction of any typographical errors.

FIC/AIC OTHER PRODUCTS

	Fixed Rate	Current Add'l. Credit	Advance Deposit
ABC	3.50	6.50	7.05
ABC - GPO	3.50	6.50	7.00
PAP C-XV	3.50	6.50	4.00
PAP Reg. C-XV	3.50	6.50	7.00
SPA II	--	--	--
SPA V	4.00	6.00	--

A = Annual
C = Compound

FIC MATURITIES REINVEST INTO FIC
AIC MATURITIES REINVEST INTO AIC

ALL NEW MONEY -- FIC

FIC/AIC MONTHLY RATE ADDITIONAL CREDIT TERM CERTIFICATE

TERM		INTEREST PAYABLE	4%+CURRENT ADD'L CREDIT		CURRENT** EFF. YIELD
3 MO 6 MO 9 MO			EFFECTIVE MAY 1- 30		
12 months	MON	(FNMMS)	4.25	=	8.25
	ANN	(FNAAS)	--	=	--
	MAT	(FNTAC)	4.75	=	8.75
	RRSP	(FRTAC)	4.75	=	8.75
18 months	MON	(FNMMS)			
	ANN	(FNAAS)			
	MAT	(FNTAC)			
	RRSP-C	(FRTAC)	5.25	=	9.25
24 months	MON	(FNMMS)	5.25	=	9.25
	ANN	(FNAAS)	5.75	=	9.75
	MAT	(FNTAC)	5.25	=	9.25
	RRSP-C	(FRTAC)	5.25	=	9.25
36 months	MON	(FNMMS)	5.25	=	9.25
	ANN	(FNAAS)	5.75	=	9.75
	MAT	(FNTAC)	5.25	=	9.25
	RRSP-C	(FRTAC)	5.25	=	9.25
48 months	MON	(FNMMS)	5.25	=	9.25
	ANN	(FNAAS)	5.75	=	9.75
	MAT	(FNTAC)	5.25	=	9.25
	RRSP-C	(FRTAC)	5.25	=	9.25
60 months	MON	(FNMMS)	5.75	=	9.75
	ANN	(FNAAS)	6.25	=	10.25
	MAT	(FNTAC)	5.75	=	9.75
	RRSP-C	(FRTAC)	5.75	=	9.75
72 to 120 months	MON	(FNMMS)	4.75	=	8.75
	ANN	(FNAAS)	5.25	=	9.25
	MAT	(FNTAC)	4.75	=	8.75
	RRSP-C	(FRTAC)	4.75	=	8.75

Notes:

Minimum Investments: :

- — $ 500.00 on FIC/AIC all terms (30 days & over) ($3,000.00 - monthly interest)
- — $1,000 on all PST terms (1 yr. & over)/ (3,000.00 monthly interest)
- — $ 600.00 for single pay mutual mutual funds and $100 minimum for subsequent deposits.

Term Deposits / Certificates commence on the date (prior to 3:00 p.m.) they are received in a PFC. Absolutely no backdating.

SCHEDULE K

SALES REPRESENTATIVE'S AGREEMENT

FIRST INVESTORS CORPORATION LTD.

ASSOCIATED INVESTORS OF CANADA LTD.

PRINCIPAL CONSULTANTS LTD.

HEAD OFFICE
2900 PRINCIPAL PLAZA, EDMONTON, ALBERTA

THIS AGREEMENT *made at Edmonton, Alberta this* day of 19

BETWEEN: FIRST INVESTORS CORPORATION LTD., ASSOCIATED INVESTORS OF CANADA LTD., and PRINCIPAL CONSULTANTS LTD. (hereinafter called the "Companies") OF THE FIRST PART

AND:

of

in the Province of (hereinafter called the "Salesman"). OF THE SECOND PART

WITNESSETH:

1. The Companies do hereby appoint the Salesman as an independent contractor to canvass for application for investment contracts and mutual funds issued and distributed by the Companies, hereinafter referred to as "Contracts", and to collect and pay over to the company issuing or distributing the Contracts all payments received by the Salesman on the said Contracts.

2. The Salesman agrees to carry on his business as an independent contractor, to pay all the expenses thereof, and to comply with all laws, ordinances, and regulations relating to his business. The Salesman agrees further not to make any secret or unauthorized agreements for sharing in or participating in commissions. Nothing herein contained shall be construed to create the relationship of employer and employee between the Companies and the Salesman, nor between any representative of the Companies and the Salesman. Within the territory allotted to the Salesman, the authority hereby conferred shall be effective and the Salesman shall be free to exercise his own judgment as to the persons whom he will solicit and the time and place of solicitation, but the Companies may from time to time prescribe rules and regulations respecting the conduct of the business covered hereby, which do not control or interfere with the freedom of action of the Salesman in the performance of his work, which rules and regulations shall be observed and conformed to by the Salesman. The Companies may authorize other persons to act in any capacity in any part or all of the territory allotted to the Salesman.

3. The Salesman agrees to explain fully the terms of the Contracts to prospective applicants, including any cash surrender values and non-withdrawable provisions relating to Contracts, and agrees further that he will not make misrepresentations or untrue statements and will not omit or evade the disclosure to applicants of material facts concerning the Contracts which applicants are entitled to know.

4. The Salesman agrees that he will not make agreement with prospective applicants for repurchase or resale of Contracts and that he will not directly or indirectly solicit, purchase, nor traffic in Contracts offered or distributed by the Companies and will not resort to "twisting" or "switching" of obligations by applicants to competitive companies or of insurance policies held by prospective applicants.

5. Applications shall be taken only on current forms furnished by the Companies. No promissory notes or like instruments shall be taken for payments on Contracts. Applications submitted by the Salesman shall be subject to acceptance or rejection by the Companies and such rejection shall not entitle the Salesman to any commission, expenses, loss of profits, or other sums and the only liability of the Companies to the Salesman shall be for the payment of commissions on applications so accepted, as hereinafter provided.

6. In the event that a claim is made against the Companies or any of them arising out of the alleged misrepresentation or misconduct of a Salesman or in the event that a Salesman fails to remit funds as required or in the event that there is a dispute between the Companies, or any of them, and the Salesman, then the Companies may retain, to the extent deemed necessary by them, any commissions accrued or to accrue to such Salesman. Further, the Companies may effect settlement of any claim or dispute with any contract holder in accordance with their own business judgment and reserve the right to terminate commissions with respect to such contract, whether or not any claim for misrepresentation or misconduct has been made. The Companies further reserve the right to refund, in whole or in part, sums paid by the contract holder and may charge back to the Salesman the whole or such proportionate part of commissions retained by, paid to, or credited to the Salesman, as the Companies shall deem equitable in such case.

7. The Salesman is without authority to alter or amend any contract or to incur any liability on behalf of the Companies. He agrees to pay all expenses incurred by him in carrying on his business without any right of reimbursement. He agrees not to interview prospective applicants or canvass for applications until he shall have secured at his own expense all licenses required by law and shall have filed applications for a surety bond coverage on a form supplied by the Companies, and paid the cost of such bond. This Agreement shall automatically terminate upon cancellation or non-renewal of a required licence or upon cancellation of coverage by the surety company for any reason.

8. The Salesman agrees that he will not, directly or indirectly, put out any advertising matter, prospectus, circular, letter, booklet, schedule, stationary, broadcasting, or literature concerning the aforesaid Contracts or the Companies, without approval in writing by the head office of the Companies.

9. This Agreement may be terminated by either party, with or without cause, without notice.

10. The Salesman agrees to remit promptly to the Companies all collections without comingling with his own funds. Remittances to the Companies shall be accompanied by collection reports in a form approved by the Companies. It is expressly stipulated and agreed between the parties hereto that if the Salesman shall fail to report and pay over any sums collected by him, such failure to report or pay shall operate as a forfeiture to the Companies, unconditionally, of all claims to compensation by the Salesman, accrued or to accrue, under this or any previous agreement, but nothing herein shall be construed to affect any claims by the Companies against the Salesman.

11. The Companies may set-off against any claim for compensation by a Salesman under this Agreement any debts due by the Salesman to the Companies, and as further security for any advances due by salesmen to the companies, that the salesman hereby signs commissions due and accruing to the companies for payment thereof.

12. No rights of the Salesman under this agreement shall be sold or assigned by him without the consent of the Companies in writing

13. Commissions shall be payable to the Salesman, in accordance with schedules put out from time to time by the Companies to the extent herein provided on all accepted applications procured by him within his allotted territory.

All Commissions arising from subsequent payments on Contracts shall be subject to the following:

(a) if a contract becomes in default, subject to the provisions of sub-paragraph (b) hereof, all subsequent commissions payable on the contract involved shall be paid to the Companies;

(b) if a contract becomes in default and before the entire commission has been paid thereon, a Salesman shall procure reinstatement of that contract, all subsequent accruing commissions on the contract involved shall be paid to the person procuring reinstatement;

(c) in the event that this Agreement is terminated by either party, no commissions shall be payable to the Salesman;

(d) in the event that the Companies in their sole discretion lend monies to or on account of the Salesman, the Salesman shall sign a promissory note as evidence of the indebtedness, if requested to do so by the Companies, and, in any event, the Salesman shall repay the same with interest at a rate to be fixed by the companies and the Companies shall have a lien on all commissions accrued or accruing and on any other monies of the Salesman until such time as the amount of such loans together with the said interest thereon have been paid to the Companies.

(e) When the salesman during the term of this agreement obtains a commission payable by another financial or investment entity other than the companies, then any such remuneration to be received from such entity in respect of such transaction will be paid directly to Principal Consultants Ltd. and shall belong to Principal Consultants Ltd. In such cases remuneration between the companies and a salesman shall be in the discretion of the companies. All such sales shall receive prior approval of Principal Consultants Ltd.

14. Upon the termination of this Agreement the Salesman agrees to return to the Companies forthwith all supplies, records, books, cards, lists of contract holders (including all copies thereof) and all other data and property pertaining to the business of the Companies, and no profits or anticipated profits other than accrued or accruing commissions as hereinbefore provided shall be payable to the Salesman and no claim by the Salesman for expenses or funds advanced by the Salesman shall be paid.

15. The Salesman agrees that he will not, at any time, use any information acquired by him during the period of this Agreement in a manner derogatory to the interests of the Companies.

16. The Salesman agrees that in the event that this Agreement is terminated by either the Salesman or the Companies, he will not, for a period of three years, and within all Provinces of Canada except the Provinces of Quebec and Manitoba, do any act or acts which may directly or indirectly induce any person to terminate his agreement with the Companies, or discourage any person from performing under his agreement with the Companies, and he will not, directly or indirectly, solicit, purchase or recommend the sale, surrender or redemption of contracts of or claims against the Companies of such contracts, nor do any act or acts which may directly or indirectly cause the holder or holders of contracts to cease their performance under their contracts.

17. Failure on the part of the Salesman to comply with any of the terms, conditions or restrictions contained herein shall disqualify the Salesman from any claim for commissions accrued or accruing at the date of such disqualification.

18. The word "default" when used herein shall mean a failure by a contract holder to make any payment at the time specified therefor under the terms of the contract.

19. The term "certificate year" when used herein shall mean the contract year of a particular investment contract.

20. The word "commission" when used herein shall include advance commissions, trail commissions, and service fees paid by the Companies.

21. The word "contract" when used herein shall include all certificates, contracts and annuities issued or distributed by the Companies.

22. The word "reinstatement" when used herein shall mean the payment to the Companies of all outstanding payments previously in default persuant to the terms of a contract.

23. This Agreement shall be effective as of the date hereof and shall be in lieu of and supersede any former sales agreement between the parties hereto.

24. This Agreement shall be deemed to be an Alberta contract and governed by the laws thereof. A waiver of any one provision shall not be deemed a waiver of any other provision, and no waiver shall be deemed made by the Companies except upon authority of the Companies in writing over the signature of one of its officers.

FIRST INVESTORS CORPORATION LTD

Per: ....

ASSOCIATED INVESTORS OF CANADA LTD.

Per: ....

PRINCIPAL CONSULTANTS LTD.

Per: ....

....

Salesman

SCHEDULE L

Copies of Investment Contracts

Associated Investors of Canada ltd.
First Investors Corporation Ltd.

CC 15005

ACCOUNT NUMBER IF NOT COMPLETED - FILL IN SIGNATURE CARD BELOW ☐

PLAN NUMBER FOR OFFICE USE ONLY

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR MRS MISS MS			

☐ **JOINT APPLICANT**: (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ **SPOUSAL CONTRIBUTOR**: PROVIDE NAME BELOW

☐ **IN TRUST FOR**: (NOT PERMITTED ON RRSP's) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR MRS MISS MS			

* M INTEREST PAID MONTHLY
A INTEREST PAID ANNUALLY
T INTEREST PAID AT MATURITY

A TERM CERTIFICATES

1. ADDITIONAL CREDIT

SERIES	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY INTEREST M A T *
☐☐☐	☐☐	☐	4.000	☐☐☐

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS.

CURRENT ADDITIONAL CREDITS PER ANNUM ☐ . ☐☐

$ ____________

* THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND

2. FIXED INTEREST

SERIES	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY INTEREST M A T *
☐☐☐	☐☐	☐	☐ . ☐☐	☐☐☐

$ ____________

B SHORT TERM CERTIFICATES

SERIES	ISSUER FIC AIC	TERM DAYS	FIXED INTEREST RATE
☐☐☐	☐☐	☐	☐ . ☐☐

INTEREST PAID AT MATURITY $ ____________

C PRINCIPAL ACCUMULATION PLAN

ISSUED BY

☐ FIRST INVESTORS CORPORATION LTD

☐ ASSOCIATED INVESTORS OF CANADA LTD

SERIES ☐☐☐

☐ INSURED

☐ NOT INSURED

REQUIRED MONTHLY PAYMENT	MONTHLY INSURANCE PAYMENT	TOTAL AMOUNT PAID
.	.	.

D PRINCIPAL ANNUITY CERTIFICATES

	SERIES	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY INTEREST M Q S A A	
SPA I	☐☐☐	☐☐		4.000		$
SPA II	☐☐☐	☐☐		4.000		$
PRINCIPAL RETIREMENT ANNUITY CERTIFICATES						
SPA V	☐☐☐	☐☐	☐	4.000	☐☐☐☐	$
IAAC	☐☐☐	☐☐	☐	☐ . ☐☐	☐☐☐☐	$

IAAC ANNUITY PAYMENT $ ____________ MONTHS DEFERRED ____________

RETIREMENT SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $ ____________

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 FOR EACH PLAN) $ ____________

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ____________

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

E RETIREMENT TERM CERTIFICATES

1. ADDITIONAL CREDIT

SERIES	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE
☐☐R	☐☐	☐	4.000

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS.

CURRENT ADDITIONAL CREDITS PER ANNUM ☐ . ☐☐

$ ____________

* THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

2. FIXED INTEREST

SERIES	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE
☐☐R	☐☐	☐	☐ . ☐☐

INTEREST COMPOUNDS ANNUALLY TO MATURITY $ ____________

F PRINCIPAL RETIREMENT ACCUMULATION PLAN

ISSUED BY

☐ FIRST INVESTORS CORPORATION LTD

☐ ASSOCIATED INVESTORS OF CANADA LTD

SERIES ☐☐R

☐ INSURED

☐ NOT INSURED

REQUIRED MONTHLY PAYMENT	MONTHLY INSURANCE PAYMENT	TOTAL AMOUNT PAID
.	.	.

SATISFIED AS FOLLOWS

____________ CHEQUE $ ____________
____________ MONEY ORDER $ ____________
____________ CASH (RECEIPT NO.) $ ____________

PROCEEDS FROM CERTIFICATE NO

____________ ☐ EST ☐ ACT $ ____________
____________ ☐ EST ☐ ACT $ ____________
____________ ☐ EST ☐ ACT $ ____________

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) PLAN(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR BELOW AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE.

TOTAL $ ____________

I HEREBY APPLY FOR THE ABOVE PLAN(S). I AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE TERMS OF THE CONTRACT ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE SIGNATURE CARD BELOW. I AGREE TO THE TERMS AND CONDITIONS PRINTED ON THE REVERSE SIDE OF THE CARD BELOW. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

SIGNED AT ____________ IN THE PROVINCE OF ____________

THIS ________ DAY OF ____________ 19 ______

____
APPLICANT'S SIGNATURE

____
CONSULTANT'S SIGNATURE

____
JOINT APPLICANT'S SIGNATURE

	NO	CONSULTANT'S SURNAME	INITIALS	%
1				
2				
3				

Form 880 (REV 11 80)

COMPANY COPY

PRINCIPAL TRUST

SIGNATURE CARD CC 15005

ACCOUNT NUMBER

Name M ____ ____________
First Middle Last

Date of Birth ___/___/___ Day Mo. Year ___/___/___ Social Insurance Number

Address ____________

____________ Postal Code

Joint or In Trust For M ____ ____________
First Middle Last

Date of Birth ___/___/___ Day Mo. Year ___/___/___ Social Insurance Number

Address ____________

____________ Postal Code

Res. Phone ____________ **Bus. Phone** ____________

Type of Account
☒ Chequing ☒ Savings ☐ In Trust For
☐ Joint (Either to sign) ☐ Joint (All must sign)
☐ Other ____________

Identification: Type ____________ No. ____________
Type ____________ No. ____________

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.)

Date ___/___/___
Day Mo. Year

Signature(s) ____________

____

Consultant ____________
Name No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES

☐ First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank. Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION**

☐ The commencement date for the plan(s) applied for shall be the date the application and funds are received by a savings officer at the nearest designated Principal Financial Centre

---

TERM CERTIFICATES (Sections A & E)

☐ Term certificates are non-cashable prior to maturity

☐ Non RRSP term certificates may be assignable only with the consent of the Company and with payment of a fee based on the currently issued schedule

EXTENDED TERM OPTION (Sections A & E)

CHOOSE ONE

☐ I do not wish at this time to extend the term of this certificate beyond the term applied for on the reverse side hereof. No interest will be paid on term certificates after maturity unless the extended term option(s) has been elected prior to maturity

☐ I wish to renew this certificate upon maturity for ______ (insert in words one to ten) further terms each identical in length to the original term and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of an original term shall be calculated and credited in the exact manner of this certificate at an interest rate equivalent to the interest rate then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event the company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify you of such occurrence forthwith

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SHORT-TERM CERTIFICATES (Section B)
(Deposits having a term of less than one year)

☐ Short term certificates are non-cashable prior to maturity

☐ Short term certificates are non-assignable

☐ Short term certificates do not qualify for the extended term option. No interest will be paid on short term certificates after maturity

---

PRINCIPAL ACCUMULATION PLANS (Sections C & F)
(Explain Each Feature)

☐ While provisions are contained in the Plan for postponement of instalments, maximum benefit will be achieved by meeting investment commitments when due

☐ The sum tendered herewith is to be applied as the initial payment on the Plan. There is an advantage in making the largest possible instalment payments

☐ ADDITIONAL CREDITS. The Plans make provision for additional credits which are over and above the fixed return. Additional credit rates are determined annually by the Board of Directors and accumulated additional credits and interest thereon are credited to Plans on completion of the fifth and tenth Plan years and are declared and credited on completion of each Plan year thereafter while the Plans are current

PRINCIPAL ACCUMULATION PLANS (Sections C & F)
(Explain Each Feature)

☐ The Plan has accumulated values as stated therein, but are less in the early years than the amount paid in

a. The value is never less than 40% of the amount paid in

b. The cash surrender value will not equal or exceed the amount paid in until the ninth year

☐ The Plan does not increase or decrease in value while instalment payments are in default. In the event of a continuous 12 months default, the Plan is automatically converted to a Paid-Up Basis

☐ The death or disability option is not available

a. if the owner or the person designated to exercise this option has attained age 60, or

b. if the Plan is in continuous default for a period of 12 months

☐ With non-registered Accumulation Plans, the owner shall have the right, exercisable within 60 days from the date of application for this Plan to receive a full refund of all monies paid hereon without interest. This right does not extend to premiums on life insurance applied for in connection with this Plan

☐ Your Plan may be insured. If you do not apply for insurance with this application, insurance cannot be added at a later date

☐ The Certificate is a valuable instrument and will be required at maturity or in case of surrender or loan request

---

ANNUITIES (Section D)
(Explain Each Feature)

SPA-I ☐ This Certificate has a surrender charge of 1% of the amount paid in if surrendered prior to the end of the fifth anniversary of the issuance of this Certificate. The annuity must commence within 20 years for a period of not less than 10 years or greater than 20 years

SPA-II ☐ This Certificate has a surrender charge of 3% of principal if the Certificate is cashed in during year 1 or 2, and if cashed during year 3, 4 or 5, the surrender charge will be 2% of principal invested. There will be no surrender fee if cashed after the 5th anniversary. The annuity must commence within 20 years for a period of not less than 10 years and not greater than 20 years

SPA-V ☐ This certificate is non-cashable, non-transferable and non-assignable

IAAC's ☐ This certificate is non-cashable, non-transferable and non-assignable

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RETIREMENT SAVINGS PLANS (Sections E & F)
(Explain Each Feature)

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act

☐ I understand that the amount paid into the plan be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act

☐ I understand that all monies paid into the plan and all profits and or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada)

☐ I understand that in accordance with the Income Tax Act (Canada) or if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 100 days of attaining age 71. The Income Tax Act does not allow the maturity date to be extended beyond the last day of the year in which I attain age 71

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name

BENEFICIARY ELECTION

Allowed only if the Plan is an RRSP, Income Averaging Annuity, or SPA-V

☐ I do not wish to designate a beneficiary for this Plan ☐ I do wish to designate a beneficiary for my ☐ RRSP ☐ IAAC ☐ SPA-V

I, ______________________ hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan on my death, the person set out hereunder, if living at my death, otherwise my estate

NAME OF BENEFICIARY ______________________

RELATIONSHIP ______________________

PRESENT ADDRESS ______________________

(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER) ______________________

DATE ______________________

SIGNATURE OF PLANHOLDER ______________________

Name and Address of Witness ______________________

Signature of Witness ______________________

ACKNOWLEDGEMENT AND REQUEST

I acknowledge that the above terms have been fully reviewed with me by the consultant and the initials above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd.

Consultant ______________________

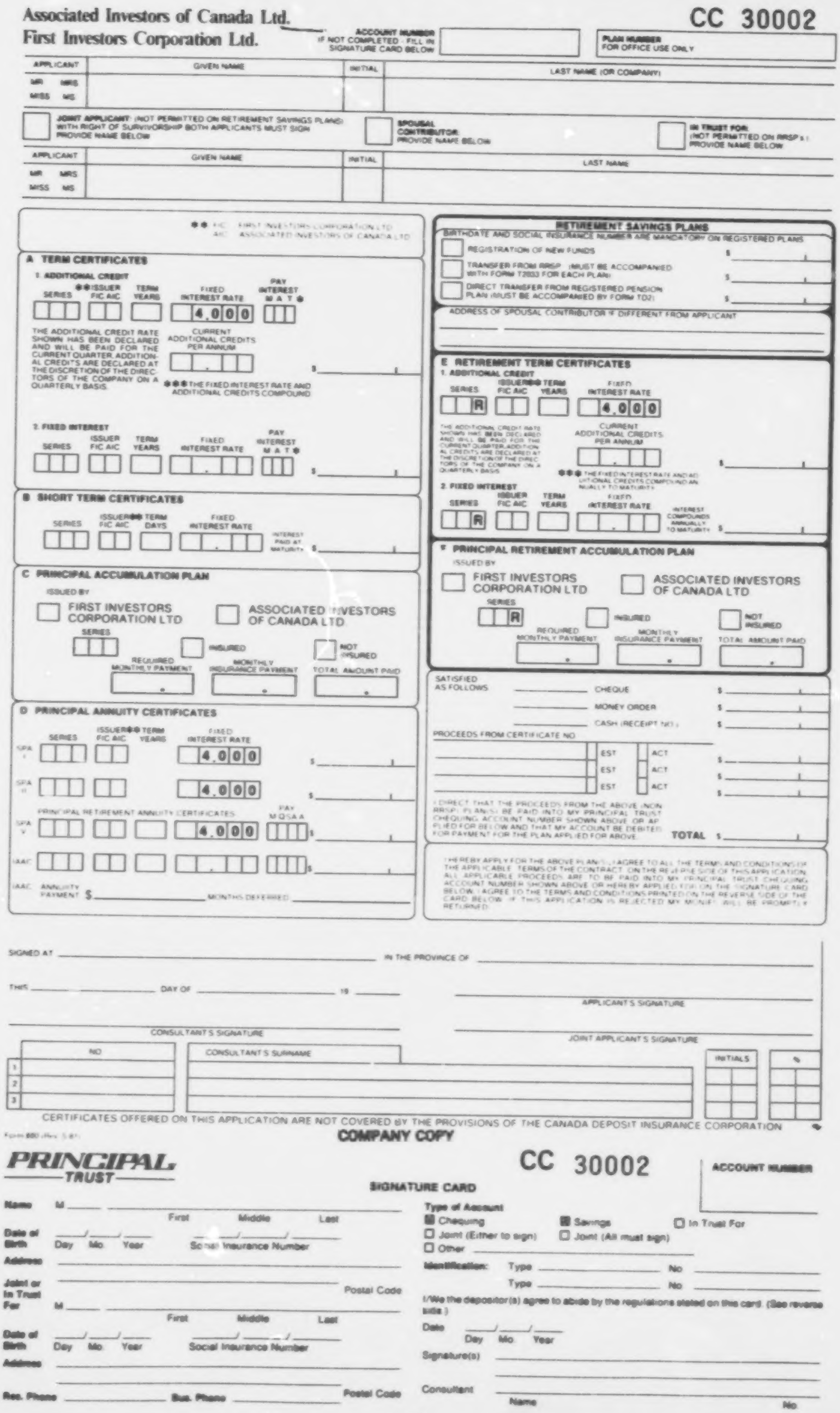
Applicant ______________________

Joint Applicant ______________________

SIGN ALL COPIES

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.



Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

CC 30002

ACCOUNT NUMBER
IF NOT COMPLETED - FILL IN SIGNATURE CARD BELOW ☐

PLAN NUMBER
FOR OFFICE USE ONLY

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR MRS MISS MS			

☐ **JOINT APPLICANT:** (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ **SPOUSAL CONTRIBUTOR:** PROVIDE NAME BELOW

☐ **IN TRUST FOR:** (NOT PERMITTED ON RRSP's) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR MRS MISS MS			

✱✱ FIC - FIRST INVESTORS CORPORATION LTD
AIC - ASSOCIATED INVESTORS OF CANADA LTD

A TERM CERTIFICATES

1. ADDITIONAL CREDIT

SERIES	✱✱ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY INTEREST M A T ✱
☐☐☐	☐☐	☐	☐ 4.000	☐☐☐

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS.

CURRENT ADDITIONAL CREDITS PER ANNUM ☐ . ☐☐ $ ____

✱✱✱ THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND

2. FIXED INTEREST

SERIES	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY INTEREST M A T ✱
☐☐☐	☐☐	☐	☐ . ☐☐	☐☐☐

$ ____

B SHORT TERM CERTIFICATES

SERIES	ISSUER✱✱ FIC AIC	TERM DAYS	FIXED INTEREST RATE	INTEREST PAID AT MATURITY
☐☐☐	☐☐	☐	☐ . ☐☐	$ ____

C PRINCIPAL ACCUMULATION PLAN

ISSUED BY
☐ FIRST INVESTORS CORPORATION LTD ☐ ASSOCIATED INVESTORS OF CANADA LTD

SERIES ☐☐☐ ☐ INSURED ☐ NOT INSURED

REQUIRED MONTHLY PAYMENT	MONTHLY INSURANCE PAYMENT	TOTAL AMOUNT PAID
.	.	.

D PRINCIPAL ANNUITY CERTIFICATES

	SERIES	ISSUER✱✱ FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY M Q S A A	
SPA I	☐☐☐	☐☐		☐ 4.000		$ ____
SPA II	☐☐☐	☐☐		☐ 4.000		$ ____
PRINCIPAL RETIREMENT ANNUITY CERTIFICATES						
SPA V	☐☐☐	☐☐	☐	☐ 4.000	☐☐☐☐	$ ____
IAAC	☐☐☐	☐☐	☐	☐ . ☐☐	☐☐☐☐	$ ____

IAAC ANNUITY PAYMENT $ ____ MONTHS DEFERRED ____

RETIREMENT SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $ ____
☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 FOR EACH PLAN) $ ____
☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ____

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT ____

E RETIREMENT TERM CERTIFICATES

1. ADDITIONAL CREDIT

SERIES	ISSUER✱✱ FIC AIC	TERM YEARS	FIXED INTEREST RATE
☐☐ R	☐☐	☐	☐ 4.000

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS.

CURRENT ADDITIONAL CREDITS PER ANNUM ☐ . ☐☐ $ ____

✱✱✱ THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

2. FIXED INTEREST

SERIES	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	INTEREST COMPOUNDS ANNUALLY TO MATURITY
☐☐ R	☐☐	☐	☐ . ☐☐	$ ____

F PRINCIPAL RETIREMENT ACCUMULATION PLAN

ISSUED BY
☐ FIRST INVESTORS CORPORATION LTD ☐ ASSOCIATED INVESTORS OF CANADA LTD

SERIES ☐☐ R ☐ INSURED ☐ NOT INSURED

REQUIRED MONTHLY PAYMENT	MONTHLY INSURANCE PAYMENT	TOTAL AMOUNT PAID
.	.	.

SATISFIED AS FOLLOWS
____ CHEQUE $ ____
____ MONEY ORDER $ ____
____ CASH (RECEIPT NO.) $ ____

PROCEEDS FROM CERTIFICATE NO
____ ☐ EST ☐ ACT $ ____
____ ☐ EST ☐ ACT $ ____
____ ☐ EST ☐ ACT $ ____

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) PLAN(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR BELOW AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE.

TOTAL $ ____

I HEREBY APPLY FOR THE ABOVE PLAN(S). I AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE TERMS OF THE CONTRACT ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE SIGNATURE CARD BELOW. I AGREE TO THE TERMS AND CONDITIONS PRINTED ON THE REVERSE SIDE OF THE CARD BELOW. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

SIGNED AT ____ IN THE PROVINCE OF ____

THIS ____ DAY OF ____ 19 ____

____
APPLICANT'S SIGNATURE

____
CONSULTANT'S SIGNATURE

____
JOINT APPLICANT'S SIGNATURE

	NO	CONSULTANT'S SURNAME	INITIALS	%
1				
2				
3				

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION

Form 800 (Rev. 5.81)

COMPANY COPY

PRINCIPAL TRUST

CC 30002

ACCOUNT NUMBER

SIGNATURE CARD

Name M ____ ____ First Middle Last
Date of Birth ____/____/____ Day Mo Year ____/____/____ Social Insurance Number
Address ____
____ Postal Code
Joint or In Trust For M ____ ____ First Middle Last
Date of Birth ____/____/____ Day Mo Year ____/____/____ Social Insurance Number
Address ____
____ Postal Code
Res. Phone ____ Bus. Phone ____

Type of Account
☒ Chequing ☒ Savings ☐ In Trust For
☐ Joint (Either to sign) ☐ Joint (All must sign)
☐ Other ____

Identification: Type ____ No ____
Type ____ No ____

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.)

Date ____/____/____ Day Mo Year

Signature(s) ____
____

Consultant ____ Name No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES

☐ First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank. Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date for the plan(s) applied for shall be the date the application and funds are received by a savings officer at the nearest designated Principal Financial Centre.

TERM CERTIFICATES (Sections A & E)

☐ Term certificates are non-cashable prior to maturity.

☐ Non RRSP term certificates may be assignable only with the consent of the Company and with payment of a fee based on the currently issued schedule.

EXTENDED TERM OPTION (Sections A & E)

CHOOSE ONE

☐ I do not wish at this time to extend the term of this certificate beyond the term applied for on the reverse side hereof. No interest will be paid on term certificates after maturity unless the extended term option(s) has been elected prior to maturity.

☐ I wish to renew this certificate upon maturity for   (insert in words one to ten) further terms each identical in length to the original term and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of an original term shall be calculated and credited in the exact manner of this certificate at an interest rate equivalent to the interest rate then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event the company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify you of such occurrence forthwith.

SHORT-TERM CERTIFICATES (Section B)
(Deposits having a term of less than one year)

☐ Short-term certificates are non-cashable prior to maturity.

☐ Short-term certificates are non-assignable.

☐ Short-term certificates do not qualify for the extended term option. No interest will be paid on short-term certificates after maturity.

PRINCIPAL ACCUMULATION PLANS (Sections C & F)
(Explain Each Feature)

☐ While provisions are contained in the Plan for postponement of instalments, maximum benefit will be achieved by meeting investment commitments when due.

☐ The sum tendered herewith is to be applied as the initial payment on the Plan. There is an advantage in making the largest possible instalment payments.

☐ ADDITIONAL CREDITS. The Plans make provision for additional credits which are over and above the fixed return. Additional credit rates are determined annually by the Board of Directors and accumulated additional credits and interest thereon are credited to Plans on completion of the fifth and tenth Plan years and are declared and credited on completion of each Plan year thereafter while the Plans are current.

PRINCIPAL ACCUMULATION PLANS (Sections C & F)
(Explain Each Feature)

☐ The Plan has accumulated values as stated therein but are less in the early years then the amount paid in.

a. The value is never less than 40% of the amount paid in.
b. The cash surrender value will not equal or exceed the amount paid in until the ninth year.

☐ The Plan does not increase or decrease in value while instalment payments are in default. In the event of a continuous 12 months default, the Plan is automatically converted to a Paid-Up Basis.

☐ The death or disability option is not available

a. if the owner or the person designated to exercise this option has attained age 60, or
b. if the Plan is in continuous default for a period of 12 months.

☐ With non-registered Accumulation Plans, the owner shall have the right, exercisable within 60 days from the date of application for this Plan to receive a full refund of all monies paid hereon without interest. This right does not extend to premiums on life insurance applied for in connection with this Plan.

☐ Your Plan may be insured. If you do not apply for insurance with this application, insurance cannot be added at a later date.

☐ The Certificate is a valuable instrument and will be required at maturity or in case of surrender or loan request.

ANNUITIES (Section D)
(Explain Each Feature)

SPA-I ☐ This Certificate has a surrender charge of 1% of the amount paid in if surrendered prior to the end of the fifth anniversary of the issuance of this Certificate. The annuity must commence within 20 years for a period of not less than 10 years or greater than 20 years.

SPA-II ☐ This Certificate has a surrender charge of 3% of principal if the Certificate is cashed in during year 1 or 2, and if cashed during year 3, 4 or 5, the surrender charge will be 2% of principal invested. There will be no surrender fee if cashed after the 5th anniversary. The annuity must commence within 20 years for a period of not less than 10 years and not greater than 20 years.

SPA-V ☐ This certificate is non-cashable, non-transferable and non-assignable.

IAAC's ☐ This certificate is non-cashable, non-transferable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections E & F)
(Explain Each Feature)

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicalbe, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION

Allowed only if the Plan is an RRSP, Income Averaging Annuity, or SPA-V

☐ I do not wish to designate a beneficiary for this Plan   ☐ I do wish to designate a beneficiary for my ☐ RRSP ☐ IAAC ☐ SPA-V

I, ______________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan on my death, the person set out hereunder, if living at my death, otherwise my estate.

______________________ NAME OF BENEFICIARY	______________________ RELATIONSHIP
______________________ ______________________ PRESENT ADDRESS	______________________ (SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)
______________________ DATE	______________________ SIGNATURE OF PLANHOLDER

Name and Address of Witness ____

____

Signature of Witness ____

ACKNOWLEDGEMENT AND REQUEST

I acknowledge that the above terms have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd.

Consultant ______________________   Applicant ______________________

SIGN ALL COPIES   Joint Applicant ______________________

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada ltd.
First Investors Corporation Ltd.

CC 66009

ACCOUNT NUMBER IF NOT COMPLETED - FILL IN SIGNATURE CARD BELOW ☐

FOR OFFICE USE ONLY — LINE NO. — PLAN NO.

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS. MISS MS.			

☐ JOINT APPLICANT: (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR: PROVIDE NAME AND SOCIAL INSURANCE NUMBER — SOCIAL INSURANCE NUMBER ___/___/___

☐ IN TRUST FOR: (NOT PERMITTED ON RRSP's.) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS. MISS MS.			

*FIC — FIRST INVESTORS CORPORATION LTD. A/C — ASSOCIATED INVESTORS OF CANADA LTD. **D — DAYS Y — YEARS ****M — MONTHLY A — ANNUALLY T — AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS.

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	*ISSUER FIC A/C	**TERM	PLUS CURRENT ADDITIONAL CREDITS PER ANNUM	***PAY INTEREST M A T	
1.				. %		$
2.				. %		$
3.				. %		$
4.				. %		$
5.				. %		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND

B FIXED INTEREST TERM CERTIFICATES

	SERIES	*ISSUER FIC A/C	**TERM	FIXED INTEREST RATE	***PAY INTEREST M A T	
6.				. %		$
7.				. %		$

C PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	SERIES	FIC A/C	TERM YEARS	FIXED INTEREST RATE	PAY M Q SA A
8.				4.000 %	

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS.

INITIAL ☐ PLUS CURRENT ADDITIONAL CREDITS PER ANNUM . % $

☐ **** I HAVE A CASH MANAGEMENT CARD. PLEASE PAY ALL APPLICABLE PROCEEDS FROM THE ABOVE NON-RRSP PLAN(S) INTO MY DAILY INTEREST SAVINGS ACCOUNT

EXTENDED TERM OPTION (SEE REVERSE)

☐ **YES.** I do wish to renew the above plan(s)

☐ **NO.** I do not wish to extend the term of the above plan(s) at this time

I HEREBY APPLY FOR THE ABOVE PLAN(S). I AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL PROCEEDS FROM THE ABOVE (NON RRSP) PLAN(S) ARE TO BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE SIGNATURE CARD BELOW. I AGREE TO THE TERMS AND CONDITIONS PRINTED ON THE REVERSE SIDE OF THE CARD BELOW. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED ****

RETIREMENT SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 FOR EACH PLAN) $

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM T2151) $

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

D ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS.

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	*ISSUER FIC A/C	TERM YEARS	PLUS CURRENT ADDITIONAL CREDIT PER ANNUM	
9.	R			. %	$
10.	R			. %	$
11.	R			. %	$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

E FIXED INTEREST RETIREMENT TERM CERTIFICATES

	SERIES	*ISSUER FIC A/C	TERM YEARS	FIXED INTEREST RATE	
12.	R			%	INTEREST COMPOUNDS $
13.	R			%	ANNUALLY TO MATURITY $

BENEFICIARY ELECTION (RRSP OR SPA V) (SEE REVERSE)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS
___ CHEQUE $
___ MONEY ORDER $
___ CASH (RECEIPT NO.) $

PROCEEDS FROM CERTIFICATE NO
☐ EST ☐ ACT $
☐ EST ☐ ACT $
☐ EST ☐ ACT $

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING OR SAVINGS ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR BELOW AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $

SIGNED AT ___ IN THE PROVINCE OF ___

THIS ___ DAY OF ___ 19___

APPLICANT'S SIGNATURE

CONSULTANT'S SIGNATURE

JOINT APPLICANT'S SIGNATURE

	NO	CONSULTANT'S SURNAME	INITIALS	%
1				
2				
3				

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

Form 080 (Rev 5/82)

COMPANY COPY

SIGNATURE CARD

CC 66009

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ___
☐ Savings ☐ Joint (All must sign) ☐ Other ___

ACCOUNT NUMBER

Name M ___ First Middle Last ___
Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number
Address ___
___ Postal Code
Joint or In Trust For M ___ First Middle Last
Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number
Address ___
___ Postal Code
Res. Phone ___ Bus. Phone ___

Identification: Type ___ No ___
Type ___ No ___
Account Owner Occupation ___ Name of Employer ___
Address of Employer ___
I We the depositor(s) agree to abide by the regulations stated on this card (See reverse side.) Date ___/___/___ Day Mo Year
Signature(s) ___
Consultant ___ Name No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES

☐ First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Albert). Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank. Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date for the plan(s) applied for shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre by 3:00 p.m. provided this application is correctly completed. Applications and payments received after 3:00 p.m. will be dated the subsequent business day.

TERM CERTIFICATES (Sections A, B, C & E)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

EXTENDED TERM OPTION (Sections A, B, D & E)

CHOOSE ONE

☐ I wish to renew the certificate(s), applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify you of such occurrence forthwith.

☐ I do not wish at this time to extend the term of the certificates beyond the term applied for on the reverse side hereof. No interest will be paid on term certificate(s) after maturity unless the extended term option(s) has been elected prior to maturity.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section C)

☐ This certificate is non-cashable, non-transferable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections D & E) (Explain Each Feature)

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION

Allowed only if the Plan is an RRSP, or SPA-V

☐ I do not wish to designate a beneficiary for the Plan(s) applied for.   ☐ I do wish to designate a beneficiary for my: ☐ RRSP; Plan(s) Sections D & E   ☐ SPA-V Plan (Section C)

I, ______________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

______________________ NAME OF BENEFICIARY

______________________ RELATIONSHIP

______________________ PRESENT ADDRESS

______________________ (SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness)______________________

Applicant______________________

Date______________________

Joint Applicant______________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Account(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except at to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofor or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

TMS-CC- 10003

ACCOUNT NUMBER
IF NOT COMPLETED - ATTACH
A COMPLETED SIGNATURE CARD

FOR OFFICE USE ONLY — LINE NO — PLAN NO

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS. MISS MS.			

☐ JOINT APPLICANT: (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR: PROVIDE NAME AND SOCIAL INSURANCE NUMBER — SOCIAL INSURANCE NUMBER / /

☐ IN TRUST FOR: (NOT PERMITTED ON RRSP's) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS. MISS MS.			

*FIC — FIRST INVESTORS CORPORATION LTD
AIC — ASSOCIATED INVESTORS OF CANADA LTD

**D — DAYS
Y — YEARS

***M — MONTHLY
A — ANNUALLY
T — AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	*ISSUER FIC AIC	**TERM	PLUS CURRENT ADDITIONAL CREDITS PER ANNUM	***PAY INTEREST M A T	
1.				. %		$
2.				. %		$
3.				. %		$
4.				. %		$
5.				. %		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND

B FIXED INTEREST TERM CERTIFICATES

	SERIES	*ISSUER FIC AIC	**TERM	FIXED INTEREST RATE	***PAY INTEREST M A T	
6.				. %		$
7.				. %		$

C PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	SERIES	FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY M Q SA A
8.				4.000 %	

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS

INITIAL ☐ PLUS CURRENT ADDITIONAL CREDITS PER ANNUM . % $

TOTAL MONEY SERVICES OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND ASK YOU TO OPEN A PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT AND ISSUE A PRINCIPAL CASH MANAGEMENT CARD. I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD. I AGREE TO PAY ALL CHARGES ON THE ACCOUNT.

☐ I HAVE OR HAVE APPLIED FOR A PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT. PLEASE PAY ALL APPLICABLE PROCEEDS FROM THE ABOVE NON RRSP PLAN(S) INTO THIS DAILY INTEREST SAVINGS ACCOUNT.

SPECIAL INSTRUCTIONS

WHOM DO YOU KNOW?

Who, among your acquaintances would benefit from hearing about Principal's services?

	NAME	ADDRESS	PHONE	OCCUP
1				
2				
3				

ACKNOWLEDGMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID INTO EITHER MY PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR OR INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON AN ATTACHED SIGNATURE CARD, AS THE CASE MAY BE. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED

RETIREMENT SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 FOR EACH PLAN) $

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

D ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	*ISSUER FIC AIC	**TERM	PLUS CURRENT ADDITIONAL CREDIT PER ANNUM	
9.	R			. %	$
10.	R			. %	$
11.	R			. %	$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

E FIXED INTEREST RETIREMENT TERM CERTIFICATES

	SERIES	*ISSUER FIC AIC	**TERM	FIXED INTEREST RATE	
12.	R			%	$
13.	R			%	$

INTEREST COMPOUNDS ANNUALLY TO MATURITY

BENEFICIARY ELECTION (RRSP OR SPA V)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

EXTENDED TERM OPTION

On RRSP term certificates with an original term of less than one year the extended term option as described on the reverse side of this application is automatically applied

For all other types of term certificates complete the following

☐ **YES.** I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO.** I do not wish to extend the term of the above term certificate(s) at this time

SATISFIED AS FOLLOWS

	CHEQUE	$
	MONEY ORDER	$
	CASH (RECEIPT NO.)	$

PROCEEDS FROM CERTIFICATE NO

	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $

SIGNED AT ________ IN THE PROVINCE OF ________

THIS ________ DAY OF ________ 19 ________

APPLICANT'S SIGNATURE

CONSULTANT'S SIGNATURE

JOINT APPLICANT'S SIGNATURE

	NO	CONSULTANT'S SURNAME	INITIALS	
1				
2				
3				

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

Form 880 (Rev. 7/83)

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES

☐ First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank. Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date for the plan(s) applied for shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre by 3:00 p.m. provided this application is correctly completed. Applications and payments received after 3:00 p.m. will be dated the subsequent business day.

TERM CERTIFICATES (Sections A, B, D & E)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, D & E)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify you of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new term certificates issued under this said extended term option.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section C)

☐ This certificate is non-cashable, non-transferable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections D & E)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is a RRSP or SPA-V)

☐ RRSP Plan(s) Sections D & E

☐ SPA-V Plan (Section C)

I, ________________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

____
NAME OF BENEFICIARY

____
RELATIONSHIP

____
(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)

____
____
PRESENT ADDRESS

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness)________________________

Applicant________________________

Date________________________

Joint Applicant________________________

Sign White Copy Only

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER
IF NOT COMPLETED - ATTACH
A COMPLETED SIGNATURE CARD

TMS-CC-22004

FOR OFFICE USE ONLY — LINE NO — PLAN NO

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR MRS MISS MS			

☐ JOINT APPLICANT (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER — SOCIAL INSURANCE NUMBER ___/___/___

☐ IN TRUST FOR (NOT PERMITTED ON RRSP's) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR MRS MISS MS			

*FIC — FIRST INVESTORS CORPORATION LTD
AIC — ASSOCIATED INVESTORS OF CANADA LTD
**D — DAYS
Y — YEARS
***M — MONTHLY
A — ANNUALLY
T — AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	*ISSUER FIC AIC	**TERM	PLUS CURRENT ADDITIONAL CREDITS PER ANNUM	***PAY INTEREST M A T	
1.				. %		$
2.				. %		$
3.				. %		$
4.				. %		$
5.				. %		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND

B FIXED INTEREST TERM CERTIFICATES

	SERIES	*ISSUER FIC AIC	**TERM	FIXED INTEREST RATE	***PAY INTEREST M A T	
6.				. %		$
7.				. %		$

C PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	SERIES	FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY M Q SA A
8.				4.000 %	

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS

INITIAL ☐ PLUS CURRENT ADDITIONAL CREDITS PER ANNUM . % $

TOTAL MONEY SERVICES OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND ASK YOU TO OPEN A PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT AND ISSUE A PRINCIPAL CASH MANAGEMENT CARD. I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD. I AGREE TO PAY ALL CHARGES ON THE ACCOUNT.

☐ I HAVE OR HAVE APPLIED FOR A PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT. PLEASE PAY ALL APPLICABLE PROCEEDS FROM THE ABOVE NON RRSP PLAN(S) INTO THIS DAILY INTEREST SAVINGS ACCOUNT

SPECIAL INSTRUCTIONS

WHOM DO YOU KNOW?

Who, among your acquaintances would benefit from hearing about Principal's services?

NAME	ADDRESS	PHONE	OCCUP
1			
2			
3			

ACKNOWLEDGMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID INTO EITHER MY PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR OR INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON AN ATTACHED SIGNATURE CARD, AS THE CASE MAY BE. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

RETIREMENT SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $
☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 FOR EACH PLAN) $
☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD3) $

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

D ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	*ISSUER FIC AIC	**TERM	PLUS CURRENT ADDITIONAL CREDIT PER ANNUM	
9.	R			. %	$
10.	R			. %	$
11.	R			. %	$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

E FIXED INTEREST RETIREMENT TERM CERTIFICATES

	SERIES	*ISSUER FIC AIC	**TERM	FIXED INTEREST RATE	
12.	R			%	INTEREST COMPOUNDS ANNUALLY TO MATURITY $
13.	R			%	$

BENEFICIARY ELECTION (RRSP OR SPA V)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

EXTENDED TERM OPTION

On RRSP term certificates with an original term of less than one year the extended term option as described on the reverse side of this application is automatically applied.

For all other types of term certificates complete the following

☐ **YES.** I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO.** I do not wish to extend the term of the above term certificate(s) at this time

SATISFIED AS FOLLOWS
________ CHEQUE $
________ MONEY ORDER $
________ CASH (RECEIPT NO.) $

PROCEEDS FROM CERTIFICATE NO

	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $

SIGNED AT ________ IN THE PROVINCE OF ________

THIS ________ DAY OF ________ 19 ________

APPLICANT'S SIGNATURE

CONSULTANT'S SIGNATURE

JOINT APPLICANT'S SIGNATURE

	NO	CONSULTANT'S SURNAME	INITIALS	%
1				
2				
3				

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

Form [illegible] (Rev. [illegible])

COMPANY COPY

SIGNATURE CARD **TMS-CC- 22004**

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ________
☐ Savings ☐ Joint (All must sign) ☐ Other ________

ACCOUNT NUMBER

Name M ________ First Middle Last

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address ________

________ Postal Code

Joint or In Trust For M ________ First Middle Last

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address ________

________ Postal Code

Res. Phone ________ **Bus. Phone** ________

Identification: Type ________ No ________
Type ________ No ________

Account Owner Occupation ________ Name of Employer ________

Address of Employer ________

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.) Date ___/___/___ Day Mo Year

Signature(s) ________

Consultant ________ Name No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES

☐ First Investors Corporation Ltd and Associated Investors of Canada Ltd are registered under the Investment Contracts Act (Alberta) Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date for the plan(s) applied for shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre by 3 00 p m provided this application is correctly completed Applications and payments received after 3 00 p m will be dated the subsequent business day

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TERM CERTIFICATES (Sections A, B, D & E)

☐ Term certificates are non-cashable and non-transferable prior to maturity

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied

EXTENDED TERM OPTION (Sections A, B, D & E)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate In the event that the company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify you of such occurrence forthwith
Upon each renewal hereunder a new term certificate shall be issued This said application shall constitute the application for all new term certificates issued under this said extended term option

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section C)

☐ This certificate is non-cashable, non-transferable and non-assignable

RETIREMENT SAVINGS PLANS (Sections D & E) (Explain Each Feature)

☐ **This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act**

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act

☐ I understand that all monies paid into the plan and all profits and or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada)

☐ I understand that in accordance with the Income Tax Act (Canada) or if applicable any Provincial Income Tax Act income tax may be payable on any benefit paid out under a Retirement Plan

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71 The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act

☐ I understand that in accordance with Section 146 of the Income Tax Act the Plan(s) will be registered in my name

BENEFICIARY ELECTION (Allowed only if the Plan is a RRSP or SPA-V)

☐ RRSP Plan(s) Sections D & E ☐ SPA-V Plan (Section C)

I, ______________________ hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death the person set out hereunder, if living at my death, otherwise my estate

______________________ NAME OF BENEFICIARY

______________________ RELATIONSHIP

____

______________________ (SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)

______________________ PRESENT ADDRESS

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd If any portion of the payment is returned for any reason the entire application will be null and void

Consultant (Witness)______________________

Applicant ______________________

Date______________________

Joint Applicant ______________________

Sign White Copy Only

REGULATIONS

1 Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time

2 When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.

3 Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.

4 The Company reserves the right to require thirty days notice of any withdrawal.

5 In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.

6 Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.

7 In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.

8 For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER
IF NOT COMPLETED - ATTACH
A COMPLETED SIGNATURE CARD ☐

TMS-CC- 37001

FOR OFFICE USE ONLY	LINE NO	PLAN NO

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR MRS MISS MS			

☐ JOINT APPLICANT (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER

SOCIAL INSURANCE NUMBER ___/___/___

☐ IN TRUST FOR (NOT PERMITTED ON RRSP's) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR MRS MISS MS			

*FIC — FIRST INVESTORS CORPORATION LTD
AIC — ASSOCIATED INVESTORS OF CANADA LTD
**D — DAYS
Y — YEARS
***M — MONTHLY
A — ANNUALLY
T — AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	*ISSUER FIC AIC	**TERM	PLUS CURRENT ADDITIONAL CREDITS PER ANNUM	***PAY INTEREST M A T	
1.				. %		$
2.				. %		$
3.				. %		$
4.				. %		$
5.				. %		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND

B FIXED INTEREST TERM CERTIFICATES

	SERIES	*ISSUER FIC AIC	**TERM	FIXED INTEREST RATE	***PAY INTEREST M A T	
6.				. %		$
7.				. %		$

C PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	SERIES	FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY M Q SA A
8.				4.000 %	

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS

INITIAL ☐ PLUS CURRENT ADDITIONAL CREDITS PER ANNUM . % $

TOTAL MONEY SERVICES OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND ASK YOU TO OPEN A PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT AND ISSUE A PRINCIPAL CASH MANAGEMENT CARD. I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD. I AGREE TO PAY ALL CHARGES ON THE ACCOUNT.

☐ I HAVE OR HAVE APPLIED FOR A PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT. PLEASE PAY ALL APPLICABLE PROCEEDS FROM THE ABOVE NON RRSP PLAN(S) INTO THIS DAILY INTEREST SAVINGS ACCOUNT

SPECIAL INSTRUCTIONS

WHOM DO YOU KNOW?

Who, among your acquaintances would benefit from hearing about Principal's services?

	NAME	ADDRESS	PHONE	OCCUP
1				
2				
3				

ACKNOWLEDGMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID INTO EITHER MY PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR OR INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON AN ATTACHED SIGNATURE CARD, AS THE CASE MAY BE. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED

RETIREMENT SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 FOR EACH PLAN) $

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

D ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	*ISSUER FIC AIC	**TERM	PLUS CURRENT ADDITIONAL CREDIT PER ANNUM	
9.	R			. %	$
10.	R			. %	$
11.	R			. %	$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

E FIXED INTEREST RETIREMENT TERM CERTIFICATES

	SERIES	*ISSUER FIC AIC	**TERM	FIXED INTEREST RATE	
12.	R			%	$
13.	R			%	$

INTEREST COMPOUNDS ANNUALLY TO MATURITY

BENEFICIARY ELECTION (RRSP OR SPA V)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

EXTENDED TERM OPTION

On RRSP term certificates with an original term of less than one year the extended term option as described on the reverse side of this application is automatically applied

For all other types of term certificates complete the following

☐ **YES.** I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO.** I do not wish to extend the term of the above term certificate(s) at this time

SATISFIED AS FOLLOWS

______	CHEQUE	$
______	MONEY ORDER	$
______	CASH (RECEIPT NO)	$

PROCEEDS FROM CERTIFICATE NO

	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $

SIGNED AT ______ IN THE PROVINCE OF ______

THIS ______ DAY OF ______ 19 ______

APPLICANT'S SIGNATURE

CONSULTANT'S SIGNATURE

JOINT APPLICANT'S SIGNATURE

	NO	CONSULTANT'S SURNAME	INITIALS	%
1				
2				
3				

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

Form 880 (Rev. 2/84)

COMPANY COPY

SIGNATURE CARD **TMS-CC- 37001**

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ______
☐ Savings ☐ Joint (All must sign) ☐ Other ______

ACCOUNT NUMBER

Name M ______ First Middle Last

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address ______

______ Postal Code

Joint or In Trust For M ______ First Middle Last

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address ______

______ Postal Code

Res. Phone ______ Bus. Phone ______

Identification: Type ______ No ______
Type ______ No ______

Account Owner Occupation ______ Name of Employer ______

Address of Employer ______

I/We the depositor(s) agree to abide by the regulations stated on this card (See reverse side) Date ___/___/___ Day Mo Year

Signature(s) ______

Consultant ______ Name No

TERMS OF THE CONTRACT
CHECK THE APPROPRIATE BOXES

☐ First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank. Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date for the plan(s) applied for shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre by 3:00 p.m. provided this application is correctly completed. Applications and payments received after 3:00 p.m. will be dated the subsequent business day.

TERM CERTIFICATES (Sections A, B, D & E)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, D & E)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify you of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new term certificates issued under this said extended term option.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section C)

☐ This certificate is non-cashable, non-transferable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections D & E) (Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is a RRSP or SPA-V)

☐ RRSP Plan(s) Sections D & E   ☐ SPA-V Plan (Section C)

I, ____________________ hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

NAME OF BENEFICIARY	RELATIONSHIP
	(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)
PRESENT ADDRESS	

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness) ____________________   Applicant ____________________

Date ____________________   Joint Applicant ____________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD) ☐

FOR OFFICE USE ONLY — LINE NO — PLAN NO

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS MISS MS			

☐ JOINT APPLICANT: (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER — SOCIAL INSURANCE NUMBER ___/___/___

☐ IN TRUST FOR (NOT PERMITTED ON RRSP's) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR MRS MISS MS			

NON-REGISTERED PLANS

*FIC — FIRST INVESTORS CORPORATION LTD
AIC — ASSOCIATED INVESTORS OF CANADA LTD
**D — DAYS
Y — YEARS
***M — MONTHLY
A — ANNUALLY
T — AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER.

IF L ☐ FIXED INTEREST RATE ☐4.000 %

	SERIES	*ISSUER FIC AIC	**TERM	PLUS CURRENT ADDITIONAL CREDITS PER ANNUM	***PAY INTEREST M A T	
1.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$
2.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$
3.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$
4.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$
5.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

B FIXED INTEREST TERM CERTIFICATES

	SERIES	*ISSUER FIC AIC	**TERM	FIXED INTEREST RATE	***PAY INTEREST M A T	
6.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$
7.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$

C PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	SERIES	FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY M Q SA A
8.	☐☐☐	☐☐	☐☐	☐4.000 %	☐☐☐☐

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS

INITIAL ☐ PLUS CURRENT ADDITIONAL CREDITS PER ANNUM ☐☐.☐☐ % $

OTHER OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE.

☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD.

☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT.

SPECIAL INSTRUCTIONS

EXTENDED TERM OPTION

☐ **YES.** I do wish to renew the above term deposit(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO.** I do not wish to extend the term of the above term deposit(s) at this time

ACKNOWLEDGEMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID TO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 OR FORM 946 FOR EACH PLAN) $

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

D ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

INITIAL ☐ FIXED INTEREST RATE ☐4.000 %

	SERIES	*ISSUER FIC AIC	TERM YEARS	PLUS CURRENT ADDITIONAL CREDIT PER ANNUM	
9.	☐☐R	☐☐	☐☐	☐☐.☐☐ %	$
10.	☐☐R	☐☐	☐☐	☐☐.☐☐ %	$
11.	☐☐R	☐☐	☐☐	☐☐.☐☐ %	$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

E FIXED INTEREST RETIREMENT TERM CERTIFICATES

	SERIES	*ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE		
12.	☐☐R	☐☐	☐☐	☐☐.☐☐ %	INTEREST COMPOUNDS ANNUALLY TO MATURITY	$
13.	☐☐R	☐☐	☐☐	☐☐.☐☐ %		$

BENEFICIARY ELECTION (RRSP OR SPA V)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS
________ CHEQUE $
________ MONEY ORDER $
________ CASH (RECEIPT NO.) $

PROCEEDS FROM CERTIFICATE NO
________ ☐ EST ☐ ACT $
________ ☐ EST ☐ ACT $
________ ☐ EST ☐ ACT $

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $

SIGNED AT ________ IN THE PROVINCE OF ________

THIS ________ DAY OF ________ 19 ____

APPLICANT'S SIGNATURE

CONSULTANT'S SIGNATURE

JOINT APPLICANT'S SIGNATURE

	NO.	CONSULTANT'S SURNAME	INITIALS	%
1				
2				
3				

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

Form 880 Rev. 10/84

COMPANY COPY

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ________ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other ________ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER

Name M ________ First ________ Middle ________ Last ________

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address ________

________ Postal Code

Joint or In Trust For M ________ First ________ Middle ________ Last ________

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address ________

________ Postal Code

Res. Phone ________ Bus. Phone ________

Identification: Type ________ No ________
Type ________ No ________

Account Owner Occupation ________ Name of Employer ________

Address of Employer ________

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.) Date ___/___/___ Day Mo Year

Signature(s) ________

Consultant ________ Name ________ No ________

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

TERM CERTIFICATES (Sections A, B, D & E)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, D & E)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE
(Section C)

☐ This certificate is non-cashable, non-transferable and non-assignable

RETIREMENT SAVINGS PLANS (Sections D & E)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada)

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name

BENEFICIARY ELECTION
(Allowed only if the Plan is a RRSP or SPA-V)

☐ RRSP Plan(s) Sections D & E

☐ SPA-V Plan (Section C)

I, ______________________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate

____
NAME OF BENEFICIARY

____
RELATIONSHIP

____

____
(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)

____
PRESENT ADDRESS

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness)______________________________

Date______________________________

Applicant______________________________

Joint Applicant______________________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD)

FOR OFFICE USE ONLY	LINE NO.	PLAN NO.

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS.			
MISS MS.			

☐ JOINT APPLICANT (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER ______/______/______

☐ IN TRUST FOR (NOT PERMITTED ON RRSP's) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS.			
MISS MS.			

NON-REGISTERED PLANS

* FIC – FIRST INVESTORS CORPORATION LTD.
AIC – ASSOCIATED INVESTORS OF CANADA LTD.

** M – MONTHLY
A – ANNUALLY
T – AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER.

1. * ISSUER FIC AIC ☐☐ TERM OF MONTHS DAYS ☐☐

INTEREST PAID M A T ** ☐☐☐

EQUAL INTEREST PAYMENTS YES ☐ NO ☐

FIXED INTEREST RATE 4.000 CURRENT ADDITIONAL CREDIT __ . __ __ INITIAL ____ $ ________

PAY INTEREST TO
OPTION ________ PLAN # ________

B FIXED INTEREST TERM CERTIFICATE

2. * ISSUER FIC AIC ☐☐ TERM OF MONTHS DAYS ☐☐

INTEREST PAID M A T ** ☐☐☐

FIXED INTEREST RATE ☐☐☐☐ EQUAL INTEREST PAYMENTS YES ☐ NO ☐

$ ________

PAY INTEREST TO
OPTION ________ PLAN # ________

OTHER OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE.
☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD.
☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT.

SPECIAL INSTRUCTIONS

____
____
____
____

EXTENDED TERM OPTION

☐ **YES,** I do wish to renew the above term deposit(s)
(See reverse side of this application for Extended Term Option terms and conditions)
☐ **NO,** I do not wish to extend the term of the above term deposit(s) at this time

ACKNOWLEDGEMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID TO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $ ________
☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 (OR FORM 946) FOR EACH PLAN $ ________
☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ________

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT
____
____

C ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATE

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

3. * ISSUER FIC AIC ☐☐ TERM OF MONTHS DAYS ☐☐

INTEREST PAID M A T ** ☐☐☐

EQUAL INTEREST PAYMENTS YES ☐ NO ☐

FIXED INTEREST RATE 4.000 CURRENT ADDITIONAL CREDIT __ . __ __ INITIAL ____ $ ________

PAY INTEREST TO
OPTION ________ PLAN # ________

D ADDITIONAL CREDIT RETIREMENT INVESTMENT CERTIFICATE

4. * ISSUER FIC AIC ☐☐ TERM OF MONTHS DAYS ☐☐ PAY INTEREST ** M A ☐☐ $ ________

FIXED INTEREST RATE __ . __ __ % CURRENT ADDITIONAL CREDIT __ . __ __ % EQUAL INTEREST PAYMENTS YES ☐ NO ☐

INTEREST OPTION CHOSEN IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

E FIXED INTEREST RETIREMENT TERM CERTIFICATES

5. * ISSUER FIC AIC ☐☐ TERM OF MONTHS DAYS ☐☐ FIXED INTEREST RATE __ . __ __ % $ ________
6. FIC AIC ☐☐ ☐☐ __ . __ __ % $ ________

INTEREST COMPOUNDS ANNUALLY TO MATURITY

BENEFICIARY ELECTION (RRSP)

☐ **YES,** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)
☐ **NO,** I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS
________ CHEQUE $ ________
________ MONEY ORDER $ ________
________ CASH (RECEIPT NO.) $ ________

PROCEEDS FROM CERTIFICATE NO.
________ ☐ EST. ☐ ACT $ ________
________ ☐ EST. ☐ ACT $ ________
________ ☐ EST. ☐ ACT $ ________

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $ ________

SIGNED AT ________________ IN THE PROVINCE OF ________________

THIS ________ DAY OF ________ 19 ____

________________ APPLICANT'S SIGNATURE

________________ CONSULTANT'S SIGNATURE

________________ JOINT APPLICANT'S SIGNATURE

	NO.	CONSULTANT'S SURNAME	INITIALS		%	
1						
2						
3						

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

Form 880 Rev. 2/85

COMPANY COPY

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ________ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other ________ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER

Name M ____ ________ First ________ Middle ________ Last

Date of Birth ____/____/____ Day Mo Year ____/____/____ Social Insurance Number

Address ____
________________________________ Postal Code

Joint or In Trust For M ____ ________ First ________ Middle ________ Last

Date of Birth ____/____/____ Day Mo Year ____/____/____ Social Insurance Number

Address ____
________________________________ Postal Code

Res. Phone ________ **Bus. Phone** ________

Identification Type ________ No ________
Type ________ No ________

________ Account Owner Occupation ________ Name of Employer

________ Address of Employer

I We the depositor(s) agree to abide by the regulations stated on this card (See reverse side.) Date ____/____/____ Day Mo Year

Signature(s) ________________
____

Consultant ________ Name ________ No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

TERM CERTIFICATES (Sections A, B, C, D & E)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, C, D & E)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option.

RETIREMENT INVESTMENT CERTIFICATE (Section D)

☐ All interest credited together with additional credits which have been allocated to this certificate will be held in an advance deposit account which earns interest daily. Interest will be credited to the account semi-annually on June 30th and December 31st of each year. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.

RETIREMENT SAVINGS PLANS (Sections C, D & E)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is a RRSP)

☐ RRSP Plan(s)
Sections C, D & E

I, ______________________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

____
NAME OF BENEFICIARY

____

____
PRESENT ADDRESS

____
RELATIONSHIP

____
(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness) ______________________________

Date ______________________________

Applicant ______________________________

Joint Applicant ______________________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD) ____________

FOR OFFICE USE ONLY	LINE NO.	PLAN NO.

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS. MISS MS.			

☐ JOINT APPLICANT (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR: PROVIDE NAME AND SOCIAL INSURANCE NUMBER ____ / ____ / ____

☐ IN TRUST FOR (NOT PERMITTED ON RRSP's OR TRUSTEE ACT FUNDS) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS. MISS MS.			

NON-REGISTERED PLANS

* FIC – FIRST INVESTORS CORPORATION LTD.
AIC – ASSOCIATED INVESTORS OF CANADA LTD.

** M – MONTHLY
A – ANNUALLY
T – AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **	EQUAL INTEREST PAYMENTS YES NO	INITIAL	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
1.						4.000	.	
	PAY INTEREST TO	OPTION ______ PLAN # ______						$
2.						4.000	.	
	PAY INTEREST TO	OPTION ______ PLAN # ______						$
3.						4.000	.	
	PAY INTEREST TO	OPTION ______ PLAN # ______						$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

B FIXED INTEREST TERM CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **	EQUAL INTEREST PAYMENTS YES NO	FIXED INTEREST RATE	
4.					.	$
5.					.	$

C ADDITIONAL CREDIT INVESTMENT CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
6.			4.000	.	$
7.			4.000	.	$

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

D PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDITS PER ANNUM	INITIAL	PAY M Q SA A
8.			4.000	. %		

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS $ ____________

OTHER OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE.

☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD

☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT.

INVESTMENT CONTRACTS ARE NOT INSURED BY CANADA DEPOSIT INSURANCE CORPORATION

SPECIAL INSTRUCTIONS

EXTENDED TERM OPTION

☐ **YES.** I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO.** I do not wish to extend the term of the above term certificate(s) at this time

WHOM DO YOU KNOW? Who, among your acquaintances would benefit from hearing about Principal's services?

	NAME	ADDRESS	PHONE	OCCUP
1				
2				
3				

ACKNOWLEDGMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID INTO MY PRINCIPAL CASH MANAGEMENT SAVINGS ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON AN ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $ ____________

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 (OR FORM 946) FOR EACH PLAN $ ____________

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ____________

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

E ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATE

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	INITIAL	
9.			4.000	.		$
10.			4.000	.		$
11.			4.000	.		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

F ADDITIONAL CREDIT RETIREMENT INVESTMENT CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
12.			4.000	.	$
13.			4.000	.	$

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

G FIXED INTEREST RETIREMENT TERM CERTIFICATES

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE		
14.			. %	INTEREST COMPOUNDS ANNUALLY TO MATURITY	$
15.			. %		$

BENEFICIARY ELECTION (RRSP)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS
____________ CHEQUE $ ____________
____________ MONEY ORDER $ ____________
____________ CASH (RECEIPT NO.) $ ____________

PROCEEDS FROM CERTIFICATE NO.

	☐	EST	☐	ACT	$
	☐	EST	☐	ACT	$
	☐	EST	☐	ACT	$

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $ ____________

COMPANY COPY

SIGNED AT ____________ IN THE PROVINCE OF ____________

THIS ________ DAY OF ____________ 19 ______

____
APPLICANT'S SIGNATURE

____
CONSULTANT'S SIGNATURE

____
JOINT APPLICANT'S SIGNATURE

	NO.	CONSULTANT'S SURNAME	INITIALS	%
1				
2				
3				

Form 580 Rev. 6/85

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ____________ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other ____________ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER

Name M ______ ____________ First Middle Last

Date of Birth ____ / ____ / ____ Day Mo Year ____ / ____ / ____ Social Insurance Number

Address ____________

____________ Postal Code

Joint or In Trust For M ______ ____________ First Middle Last

Date of Birth ____ / ____ / ____ Day Mo Year ____ / ____ / ____ Social Insurance Number

Address ____________

____________ Postal Code

Res. Phone ____________ **Bus. Phone** ____________

Identification: Type ____________ No ____________
Type ____________ No ____________

____________ Account Owner Occupation ____________ Name of Employer

____________ Address of Employer

I We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.) Date ____ / ____ / ____ Day Mo Year

Signature(s) ____________
____

Consultant ____________ Name No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

☐ I acknowledge that these are not Trust Funds pursuant to the Trustee Act.

TERM CERTIFICATES (Sections A, B, C, E, F & G)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, C, E, F & G)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option.

INVESTMENT CERTIFICATE (Section C & F)

☐ All interest credited together with additional credits which have been allocated to this certificate will be held in an advance deposit account which earns interest daily. Interest will be credited to the account semi-annually on June 30th and December 31st of each year. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section D)

☐ This certificate is non-cashable, non-transferrable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections E, F & G)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is an RRSP or SPAV)

☐ RRSP Plan(s) Sections E, F & G ☐ SPAV Plan (Section D)

I, ______________________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

______________________________ NAME OF BENEFICIARY	______________________________ RELATIONSHIP
______________________________	______________________________ (SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)
______________________________ PRESENT ADDRESS	

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd If any portion of the payment is returned for any reason the entire application will be null and void

Consultant (Witness)______________________________

Applicant______________________________

Date______________________________

Joint Applicant______________________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD)

FOR OFFICE USE ONLY	LINE NO.	PLAN NO.

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS. MISS MS.			

☐ JOINT APPLICANT: (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR: PROVIDE NAME AND SOCIAL INSURANCE NUMBER ____ / ____ / ____

☐ IN TRUST FOR: (NOT PERMITTED ON RRSPs OR TRUSTEE ACT FUNDS) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS. MISS MS.			

NON-REGISTERED PLANS

* FIC – FIRST INVESTORS CORPORATION LTD.
AIC – ASSOCIATED INVESTORS OF CANADA LTD.

** M – MONTHLY
A – ANNUALLY
T – AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER.

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **	EQUAL INTEREST PAYMENTS YES NO	INITIAL	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
1.						4.000	.	
	PAY INTEREST TO OPTION ______ PLAN # ______							$ ______
2.						4.000	.	
	PAY INTEREST TO OPTION ______ PLAN # ______							$ ______
3.						4.000	.	
	PAY INTEREST TO OPTION ______ PLAN # ______							$ ______

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

B FIXED INTEREST TERM CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **	EQUAL INTEREST PAYMENTS YES NO	FIXED INTEREST RATE	
4.					.	$ ______
5.						$ ______

C ADDITIONAL CREDIT INVESTMENT CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
6.			4.000	.	$ ______
7.			4.000	.	$ ______

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

D PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDITS PER ANNUM	INITIAL	PAY M Q SA A
8.			4.000	. %		

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS.

$ ______

OTHER OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE.

☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD.

☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT.

SPECIAL INSTRUCTIONS

____

EXTENDED TERM OPTION

☐ **YES** I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO** I do not wish to extend the term of the above term certificate(s) at this time

ACKNOWLEDGEMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID TO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $ ______

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 (OR FORM 946) FOR EACH PLAN $ ______

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ______

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

____

____

E ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATE

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER.

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	INITIAL	
9.			4.000	.		$ ______
10.			4.000	.		$ ______
11.			4.000	.		$ ______

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

F ADDITIONAL CREDIT RETIREMENT INVESTMENT CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
12.			4.000	.	$ ______
13.			4.000	.	$ ______

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

G FIXED INTEREST RETIREMENT TERM CERTIFICATES

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE		
14.			. %	INTEREST COMPOUNDS ANNUALLY TO MATURITY	$ ______
15.	FIC AIC		. %		$ ______

BENEFICIARY ELECTION (RRSP)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS

______	CHEQUE	$ ______
______	MONEY ORDER	$ ______
______	CASH (RECEIPT NO.)	$ ______

PROCEEDS FROM CERTIFICATE NO

______	☐ EST	☐ ACT	$ ______
______	☐ EST	☐ ACT	$ ______
______	☐ EST	☐ ACT	$ ______

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE.

TOTAL $ ______

COMPANY COPY

SIGNED AT ______________ IN THE PROVINCE OF ______________

THIS ______ DAY OF ______________ 19 ______

____
APPLICANT'S SIGNATURE

____
CONSULTANT'S SIGNATURE

____
JOINT APPLICANT'S SIGNATURE

	NO.	CONSULTANT'S SURNAME
1		
2		
3		

INITIALS		%	

INVESTMENT CONTRACTS ARE NOT INSURED BY CANADA DEPOSIT INSURANCE CORPORATION

Form 880 Rev. 6/85

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ______ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other ______ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER

Name M ______ First ______ Middle ______ Last ______

Date of Birth ____ / ____ / ____ Day Mo Year ____ / ____ / ____ Social Insurance Number

Address ______________

______________ Postal Code

Joint or In Trust For M ______ First ______ Middle ______ Last ______

Date of Birth ____ / ____ / ____ Day Mo Year ____ / ____ / ____ Social Insurance Number

Address ______________

______________ Postal Code

Res. Phone ______________ **Bus. Phone** ______________

Identification Type ______________ No ______________
Type ______________ No ______________

______________ Account Owner Occupation ______________ Name of Employer

______________ Address of Employer

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.) Date ____ / ____ / ____ Day Mo Year

Signature(s) ______________

____

Consultant ______________ Name ______________ No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

☐ I acknowledge that these are not Trust Funds pursuant to the Trustee Act.

TERM CERTIFICATES (Sections A, B, C, E, F & G)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, C, E, F & G)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option.

INVESTMENT CERTIFICATE (Section C & F)

☐ All interest credited together with additional credits which have been allocated to this certificate will be held in an advance deposit account which earns interest daily. Interest will be credited to the account semi-annually on June 30th and December 31st of each year. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE
(Section D)

☐ This certificate is non-cashable, non-transferrable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections E, F & G)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is an RRSP or SPAV)

☐ RRSP Plan(s) Sections E, F & G ☐ SPAV Plan (Section D)

I, ______________________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

____
NAME OF BENEFICIARY

____
RELATIONSHIP

____

____
(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)

____
PRESENT ADDRESS

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness)______________________________ Applicant ______________________________

Date______________________________ ____________ Joint Applicant ______________________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

General Business Forms 15739

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD) ☐

FOR OFFICE USE ONLY — LINE NO. — PLAN NO.

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS. MISS MS.			

☐ JOINT APPLICANT (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER ____/____/____

☐ IN TRUST FOR: (NOT PERMITTED ON RRSP's OR TRUSTEE ACT FUNDS) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS. MISS MS.			

NON-REGISTERED PLANS

* FIC - FIRST INVESTORS CORPORATION LTD
AIC - ASSOCIATED INVESTORS OF CANADA LTD

** M - MONTHLY
A - ANNUALLY
T - AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **	SERIAL INTEREST PAYMENTS YES NO	INITIAL	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
1.						4.000	.	$
2.						4.000	.	$
3.						4.000	.	$

PAY INTEREST TO (1.) OPTION ________ PLAN # ________

PAY INTEREST TO (2.) OPTION ________ PLAN # ________

PAY INTEREST TO (3.) OPTION ________ PLAN # ________

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

B FIXED INTEREST TERM CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **	SERIAL INTEREST PAYMENTS YES NO	FIXED INTEREST RATE	
4.					.	$
5.					.	$

C ADDITIONAL CREDIT INVESTMENT CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
6.			4.000	.	$
7.			4.000	.	$

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

D PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDITS PER ANNUM	INITIAL	PAY M Q SA A
8.			4.000	. %		

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS $ ________

OTHER OPTIONS

- ☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE.
- ☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD.
- ☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT

SPECIAL INSTRUCTIONS

____

EXTENDED TERM OPTION

☐ **YES** I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO**. I do not wish to extend the term of the above term certificate(s) at this time

ACKNOWLEDGEMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID TO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

- ☐ REGISTRATION OF NEW FUNDS $ ________
- ☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 (OR FORM 946) FOR EACH PLAN $ ________
- ☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ________

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

____

____

E ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATE

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	INITIAL	
9.			4.000	.		$
10.			4.000	.		$
11.			4.000	.		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

F ADDITIONAL CREDIT RETIREMENT INVESTMENT CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
12.			4.000	.	$
13.			4.000	.	$

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

G FIXED INTEREST RETIREMENT TERM CERTIFICATES

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE		
14.			. %	INTEREST COMPOUNDS ANNUALLY TO MATURITY	$
15.	FIC AIC		. %		$

BENEFICIARY ELECTION (RRSP)

☐ **YES**, I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO**, I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS

________	CHEQUE	$
________	MONEY ORDER	$
________	CASH (RECEIPT NO.)	$

PROCEEDS FROM CERTIFICATE NO.

	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $ ________

SIGNED AT ________________ IN THE PROVINCE OF ________________

THIS ________ DAY OF ________________ 19 ________

________________ APPLICANT'S SIGNATURE

________________ CONSULTANT'S SIGNATURE

________________ JOINT APPLICANT'S SIGNATURE

	NO.	CONSULTANT'S SURNAME	INITIALS		%	
1						
2						
3						

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

Form 860 Rev. 6/85

COMPANY COPY

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ________ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other ________ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER ________

Name M ________ First ________ Middle ________ Last ________

Date of Birth ____/____/____ Day Mo Year ____/____/____ Social Insurance Number

Address ________________

________________ Postal Code

Joint or In Trust For M ________ First ________ Middle ________ Last ________

Date of Birth ____/____/____ Day Mo Year ____/____/____ Social Insurance Number

Address ________________

________________ Postal Code

Res. Phone ________ Bus. Phone ________

Identification: Type ________ No ________

Type ________ No ________

________ Account Owner Occupation ________ Name of Employer

________ Address of Employer

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.) Date ____/____/____ Day Mo Year

Signature(s) ________________

____

Consultant ________ Name ________ No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

☐ I acknowledge that these are not Trust Funds pursuant to the Trustee Act.

TERM CERTIFICATES (Sections A, B, C, E, F & G)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, C, E, F & G)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option.

INVESTMENT CERTIFICATE (Section C & F)

☐ All interest credited together with additional credits which have been allocated to this certificate will be held in an advance deposit account which earns interest daily. Interest will be credited to the account semi-annually on June 30th and December 31st of each year. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section D)

☐ This certificate is non-cashable, non-transferrable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections E, F & G) (Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is an RRSP or SPAV)

☐ RRSP Plan(s) Sections E, F & G ☐ SPAV Plan (Section D)

I, ______________________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

____
NAME OF BENEFICIARY

____
RELATIONSHIP

____

____
(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)

____
PRESENT ADDRESS

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness)______________________________

Applicant______________________________

Date______________________________

Joint Applicant______________________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD)

FOR OFFICE USE ONLY	LINE NO.	PLAN NO.

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS. MISS MS.			

☐ JOINT APPLICANT: (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER ____ / ____ / ____

☐ IN TRUST FOR: (NOT PERMITTED ON RRSP's OR TRUSTEE ACT FUNDS) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS. MISS MS.			

NON-REGISTERED PLANS

* FIC – FIRST INVESTORS CORPORATION LTD.
AIC – ASSOCIATED INVESTORS OF CANADA LTD.

** M – MONTHLY
A – ANNUALLY
T – AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **	EQUAL INTEREST PAYMENTS YES NO	INITIAL	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
1.						4.000	.	$
2.						4.000	.	$
3.						4.000	.	$

PAY INTEREST TO (1.): OPTION ________ PLAN # ________

PAY INTEREST TO (2.): OPTION ________ PLAN # ________

PAY INTEREST TO (3.): OPTION ________ PLAN # ________

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

B FIXED INTEREST TERM CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **	EQUAL INTEREST PAYMENTS YES NO	FIXED INTEREST RATE	
4.					.	$
5.					.	$

C ADDITIONAL CREDIT INVESTMENT CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
6.			4.000	.	$
7.			4.000	.	$

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

D PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDITS PER ANNUM	INITIAL	PAY M Q SA A	
8.			4.000	. %			$

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS

OTHER OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE.

☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD.

☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT.

SPECIAL INSTRUCTIONS

____

EXTENDED TERM OPTION

☐ **YES** I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO** I do not wish to extend the term of the above term certificate(s) at this time

ACKNOWLEDGEMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID TO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $ ________

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 (OR FORM 946) FOR EACH PLAN $ ________

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ________

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

____

____

E ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATE

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	INITIAL	
9.			4.000	.		$
10.			4.000	.		$
11.			4.000	.		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

F ADDITIONAL CREDIT RETIREMENT INVESTMENT CERTIFICATE

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
12.			4.000	.	$
13.			4.000	.	$

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

G FIXED INTEREST RETIREMENT TERM CERTIFICATES

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE		
14.			. %	INTEREST COMPOUNDS ANNUALLY TO MATURITY	$
15.	FIC AIC		. %		$

BENEFICIARY ELECTION (RRSP)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS

________	CHEQUE	$
________	MONEY ORDER	$
________	CASH (RECEIPT NO.)	$

PROCEEDS FROM CERTIFICATE NO.

	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$
	☐ EST	☐ ACT	$
		TOTAL	$

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

SIGNED AT ________________ IN THE PROVINCE OF ________________

THIS ________ DAY OF ________ 19 ________

________________ APPLICANT'S SIGNATURE

________________ CONSULTANT'S SIGNATURE

________________ JOINT APPLICANT'S SIGNATURE

	NO.	CONSULTANT'S SURNAME	INITIALS		%	
1						
2						
3						

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

Form 880 Rev. 6/85

COMPANY COPY

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ________ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other ________ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER

Name M ________ First ________ Middle ________ Last ________

Date of Birth Day ____ / Mo ____ / Year ____ Social Insurance Number ____ / ____ / ____

Address ________________

________________ Postal Code

Joint or In Trust For M ________ First ________ Middle ________ Last ________

Date of Birth Day ____ / Mo ____ / Year ____ Social Insurance Number ____ / ____ / ____

Address ________________

________________ Postal Code

Res. Phone ________ **Bus. Phone** ________

Identification: Type ________ No ________
Type ________ No ________

Account Owner Occupation ________ Name of Employer ________

Address of Employer ________

I We the depositor(s) agree abide by the regulations stated on this card. (See reverse side.) Date ____ / ____ / ____ Day Mo Year

Signature(s) ________________

____

Consultant ________________ Name No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

☐ I acknowledge that these are not Trust Funds pursuant to the Trustee Act.

TERM CERTIFICATES (Sections A, B, C, E, F & G)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, C, E, F & G)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option.

INVESTMENT CERTIFICATE (Section C & F)

☐ All interest credited together with additional credits which have been allocated to this certificate will be held in an advance deposit account which earns interest daily. Interest will be credited to the account semi-annually on June 30th and December 31st of each year. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section D)

☐ This certificate is non-cashable, non-transferrable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections E, F & G)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is an RRSP or SPAV)

☐ RRSP Plan(s) Sections E, F & G ☐ SPAV Plan (Section D)

I, ______________________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

NAME OF BENEFICIARY ______________________________

RELATIONSHIP ______________________________

____

(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER) ______________________________

PRESENT ADDRESS ______________________________

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness)______________________________

Applicant______________________________

Date______________________________

Joint Applicant______________________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD)

FOR OFFICE USE ONLY	LINE NO.	PLAN NO.

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS. MISS MS.			

☐ JOINT APPLICANT: (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR: PROVIDE NAME AND SOCIAL INSURANCE NUMBER ____ / ____ / ____

☐ IN TRUST FOR: (NOT PERMITTED ON RRSP's OR TRUSTEE ACT FUNDS) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS. MISS MS.			

NON-REGISTERED PLANS

* FIC – FIRST INVESTORS CORPORATION LTD.
AIC – ASSOCIATED INVESTORS OF CANADA LTD.

A MONTHLY ADDITIONAL CREDIT TERM CERTIFICATE

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S MONTHLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR MONTH.

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	INTEREST PAID M A T **		INITIAL	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT
1.						4.000	.
							$
2.						4.000	.
							$
3.						4.000	.
							$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

OTHER OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE.

☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD.

☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT.

SPECIAL INSTRUCTIONS

EXTENDED TERM OPTION

☐ **YES.** I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ **NO.** I do not wish to extend the term of the above term certificate(s) at this time

ACKNOWLEDGEMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID TO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $ ____

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 (OR FORM 946) FOR EACH PLAN $ ____

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ____

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

B MONTHLY ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATE

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE S MONTHLY ANNIVERSARY ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR MONTH

	* ISSUER FIC AIC	TERM OF MONTHS DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	INITIAL	
4.			4.000	.		$
5.			4.000	.		$
6.			4.000	.		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

BENEFICIARY ELECTION (RRSP)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS

____ CHEQUE $ ____
____ MONEY ORDER $ ____
____ CASH (RECEIPT NO.) $ ____

PROCEEDS FROM CERTIFICATE NO.

	☐	EST.	☐	ACT	$
	☐	EST	☐	ACT	$
	☐	EST.	☐	ACT	$

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $ ____

SIGNED AT ____ IN THE PROVINCE OF ____

THIS ____ DAY OF ____ 19 ____

APPLICANT'S SIGNATURE

CONSULTANT'S SIGNATURE

JOINT APPLICANT'S SIGNATURE

	NO.	CONSULTANT'S SURNAME
1		
2		
3		

INITIALS		%	

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION.

FORM 1010 (10/85)

COMPANY COPY

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ____ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other ____ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER

Name M ____ First ____ Middle ____ Last

Date of Birth ____ Day / ____ Mo / ____ Year ____ / ____ / ____ Social Insurance Number

Address ____

____ Postal Code

Joint or In Trust For M ____ First ____ Middle ____ Last

Date of Birth ____ Day / ____ Mo / ____ Year ____ / ____ / ____ Social Insurance Number

Address ____

____ Postal Code

Res. Phone ____ Bus. Phone ____

Identification: Type ____ No ____
Type ____ No ____

Account Owner Occupation ____ Name of Employer ____

Address of Employer ____

I We the depositor(s) agree to abide by the regulations stated on this card (See reverse side.) Date ____ Day / ____ Mo / ____ Year

Signature(s) ____

Consultant ____ Name ____ No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

☐ I acknowledge that these are not Trust Funds pursuant to the Trustee Act.

TERM CERTIFICATES (Sections A & B)

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

EXTENDED TERM OPTION (Sections A & B)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option.

RETIREMENT SAVINGS PLANS (Section B)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is an RRSP or SPAV)

☐ RRSP Plan(s)
Section B

I, ______________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

NAME OF BENEFICIARY	RELATIONSHIP
	(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)
PRESENT ADDRESS	

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness)______________________

Applicant______________________

Date______________________

Joint Applicant______________________

SIGN WHITE COPY ONLY

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.

2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.

3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.

4. The Company reserves the right to require thirty days notice of any withdrawal.

5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.

6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.

7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.

8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD) ☐

FOR OFFICE USE ONLY	LINE NO.	PLAN NO.

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR. MRS. MISS MS.			

☐ JOINT APPLICANT: (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER ____ / ____ / ____

☐ IN TRUST FOR: (NOT PERMITTED ON RRSP's OR TRUSTEE ACT FUNDS) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR. MRS. MISS MS.			

NON-REGISTERED PLANS

* FIC – FIRST INVESTORS CORPORATION LTD.
AIC – ASSOCIATED INVESTORS OF CANADA LTD.

** M – MONTHLY
A – ANNUALLY
T – AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER.

	* ISSUER FIC	AIC	TERM OF MONTHS	DAYS	INTEREST PAID M	A	T **	EQUAL INTEREST PAYMENTS YES	NO	INITIAL	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
1.											4.000	.	
PAY INTEREST TO	OPTION ____ PLAN # ____												$
2.											4.000	.	
PAY INTEREST TO	OPTION ____ PLAN # ____												$
3.											4.000	.	
PAY INTEREST TO	OPTION ____ PLAN # ____												$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

B FIXED INTEREST TERM CERTIFICATE

	* ISSUER FIC	AIC	TERM OF MONTHS	DAYS	INTEREST PAID M	A	T **	EQUAL INTEREST PAYMENTS YES	NO	FIXED INTEREST RATE	
4.										.	$
5.										.	$

C ADDITIONAL CREDIT INVESTMENT CERTIFICATE

	* ISSUER FIC	AIC	TERM OF MONTHS	DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
6.					4.000	.	$
7.					4.000	.	$

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

D PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	ISSUER FIC	AIC	TERM YEARS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDITS PER ANNUM	INITIAL	PAY M	Q	SA	A
8.				4.000	. %					

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS $

OTHER OPTIONS

- ☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE.
- ☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD.
- ☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT.
- ☐ THIS PLAN IS PART OF A PRINCIPAL TRUST RETIREMENT INCOME FUND.

INVESTMENT CONTRACTS ARE NOT INSURED BY CANADA DEPOSIT INSURANCE CORPORATION

SPECIAL INSTRUCTIONS

EXTENDED TERM OPTION

- ☐ **YES**, I do wish to renew the above term certificate(s) (See reverse side of this application for Extended Term Option terms and conditions)
- ☐ **NO**, I do not wish to extend the term of the above term certificate(s) at this time

WHOM DO YOU KNOW? Who, among your acquaintances would benefit from hearing about Principal's services?

	NAME	ADDRESS	PHONE	OCCUP
1				
2				

ACKNOWLEDGMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID INTO MY PRINCIPAL CASH MANAGEMENT SAVINGS ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON AN ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

- ☐ REGISTRATION OF NEW FUNDS $
- ☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 (OR FORM 946) FOR EACH PLAN $
- ☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

E ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATE

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER.

	* ISSUER FIC	AIC	TERM OF MONTHS	DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	INITIAL	
9.					4.000	.		$
10.					4.000	.		$
11.					4.000	.		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

F ADDITIONAL CREDIT RETIREMENT INVESTMENT CERTIFICATE

	* ISSUER FIC	AIC	TERM OF MONTHS	DAYS	FIXED INTEREST RATE	CURRENT ADDITIONAL CREDIT	
12.					4.000	.	$
13.					4.000	.	$

ANNUAL INTEREST IS PAID INTO THE ADVANCE DEPOSIT ACCOUNT ON WHICH INTEREST IS CALCULATED DAILY AND PAID SEMI-ANNUALLY.

G FIXED INTEREST RETIREMENT TERM CERTIFICATES

	* ISSUER FIC	AIC	TERM OF MONTHS	DAYS	FIXED INTEREST RATE		
14.					. %	INTEREST COMPOUNDS ANNUALLY TO MATURITY	$
15.					. %		$

BENEFICIARY ELECTION (RRSP)

- ☐ **YES**, I do wish to designate a beneficiary for the above plan(s) (Complete beneficiary election on reverse side of this application)
- ☐ **NO**, I do not wish to designate a beneficiary for the above plan(s)

SATISFIED AS FOLLOWS
____ CHEQUE $
____ MONEY ORDER $
____ CASH (RECEIPT NO.) $

PROCEEDS FROM CERTIFICATE NO.

	☐	EST	☐	ACT	$
	☐	EST	☐	ACT	$
	☐	EST	☐	ACT	$

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE.

TOTAL $

COMPANY COPY

SIGNED AT ____ IN THE PROVINCE OF ____

THIS ____ DAY OF ____ 19 ____

APPLICANT'S SIGNATURE

CONSULTANT'S SIGNATURE

JOINT APPLICANT'S SIGNATURE

	NO.	CONSULTANT'S SURNAME
1		
2		
3		

INITIALS		%	

FORM 880 REV. 12/86

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ____ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other ____ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER

Name M ____ First ____ Middle ____ Last ____

Date of Birth ____ / ____ / ____ Day Mo Year ____ / ____ / ____ Social Insurance Number

Address ____

____ Postal Code

Joint or In Trust For M ____ First ____ Middle ____ Last ____

Date of Birth ____ / ____ / ____ Day Mo Year ____ / ____ / ____ Social Insurance Number

Address ____

____ Postal Code

Res. Phone ____ Bus. Phone ____

Identification: Type ____ No ____
Type ____ No ____

Account Owner Occupation ____ Name of Employer ____

Address of Employer ____

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.) Date ____ / ____ / ____ Day Mo Year

Signature(s) ____

Consultant ____ Name ____ No

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd. and Associated Investors of Canada Ltd. are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

☐ I acknowledge that these are not Trust Funds pursuant to the Trustee Act.

TERM CERTIFICATES (Sections A, B, C, E, F & G)

☐ Term certificates are non-cashable and non-transferable prior to maturity.

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule.

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity.

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied.

EXTENDED TERM OPTION (Sections A, B, C, E, F & G)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option.

INVESTMENT CERTIFICATE (Section C & F)

☐ All interest credited together with additional credits which have been allocated to this certificate will be held in an advance deposit account which earns interest daily. Interest will be credited to the account semi-annually on June 30th and December 31st of each year. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section D)

☐ This certificate is non-cashable, non-transferrable and non-assignable.

RETIREMENT SAVINGS PLANS (Sections E, F & G)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act.

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act.

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act.

☐ I understand that all monies paid into the plan and all profits and/or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada).

☐ I understand that in accordance with the Income Tax Act (Canada) or, if applicable, any Provincial Income Tax Act, income tax may be payable on any benefit paid out under a Retirement Plan.

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71.

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act.

☐ I understand that in accordance with Section 146 of the Income Tax Act, the Plan(s) will be registered in my name.

BENEFICIARY ELECTION
(Allowed only if the Plan is an RRSP or SPAV)

☐ RRSP Plan(s) Sections E, F & G ☐ SPAV Plan (Section D)

I, ______________________________, hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and, pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death, the person set out hereunder, if living at my death, otherwise my estate.

____
NAME OF BENEFICIARY

____
RELATIONSHIP

____

____
(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)

____
PRESENT ADDRESS

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation.

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void.

Consultant (Witness)______________________________

Date______________________________

Applicant ______________________________

Joint Applicant ______________________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time.
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received.
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish.
4. The Company reserves the right to require thirty days notice of any withdrawal.
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay.
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement.
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them.
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest.

PRINCIPAL
GROUP LTD.

PROMISSORY NOTES

PGL 09434

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR MRS MISS MS			

ADDRESS	STREET NO	STREET NAME	CITY	PROVINCE	POSTAL CODE

☐ APPLICANT IF NON RESIDENT — COUNTRY ______ BUSINESS PHONE NUMBER ______ RES ______

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)

ADDRESS	STREET NO	STREET NAME	CITY	PROVINCE	POSTAL CODE

I/WE hereby apply for a PRINCIPAL GROUP LTD PROMISSORY NOTE INTEREST PAID SEMI ANNUAL

TERM YEARS	INTEREST RATE	PAY INTEREST @ M A T	AMOUNT
01	11.00	~~M A T~~	$ 1 300 000 | 00

* M — INTEREST PAID MONTHLY
A — INTEREST PAID ANNUALLY
T — INTEREST COMPOUNDED ANNUALLY TO MATURITY

I/WE acknowledge receipt of the current PRINCIPAL GROUP LTD information memorandum for SHORT TERM PROMISSORY NOTES

I/WE acknowledge that within two days of receipt of this application at the Head Office of the company this application will be accepted or rejected. If rejected all monies will be refunded immediately.

I/WE request that all interest and maturity payments be made to a PRINCIPAL SAVINGS AND TRUST COMPANY chequing account number ______ or hereby applied for on the signature card attached. I agree to the terms and conditions printed on the reverse side of the card.

PRINCIPAL GROUP LTD. NOTES are not covered by Canada Deposit Insurance Corporation.

SIGNED ______ IN THE PROVINCE OF ______

THIS ______ DAY OF ______ 19____ ______ APPLICANT'S SIGNATURE

______ SIGNATURE OF WITNESS ______ JOINT APPLICANT'S SIGNATURE

OFFICE USE ONLY

APPLICATION CORRECTLY COMPLETED
SIGNED ______ AREA MANAGER
APPLICATION ACCEPTED
SIGNED ______ HEAD OFFICE AUTHORIZED REPRESENTATIVE

FORM 881 (5/81)

CONSULTANT COPY

FORM 11

THE SECURITIES ACT

PGL 09434

REPORT OF A TRADE MADE UNDER SUBSECTION 3 OF SECTION 19 OF THE SECURITIES ACT (ALBERTA)

1 Full name and address of vendor: Principal Group Ltd., 2900 Principal Plaza Building, 10303 Jasper Avenue, Edmonton, Alberta.
2 Name and address of the issuer of the security traded: Principal Group Ltd., 2900 Principal Plaza, 10303 Jasper Avenue, Edmonton, Alberta
3 Details of Purchase PRINCIPAL GROUP LTD PROMISSORY NOTE Date of purchase ______
Name and address of purchaser: ______
Description of securities purchased: PROMISSORY NOTE Purchase price 1300 000 00
4 Give name and address of any person acting as agent in connection with this trade and the compensation paid or to be paid to such agent ______

CERTIFICATE OF PURCHASER

The undersigned hereby certifies that the statements made in this report are true and that the purchase was made as pr[illegible] only and not with a view to resale or distribution and undertakes further that he will file with the Commission within ten days of the re[illegible] securities purchased hereunder a report prepared in accordance with Form 12.

DATED at Edmonton, Alberta.

By ______ By ______

CERTIFICATE OF VENDOR AND AGENT OF VENDOR

The undersigned hereby certifies that the statements made in this report are true.

DATED at Edmonton, Alberta. PRINCIPAL GROUP LTD

Per ______ Per: ______

DATED at Edmonton, Alberta. ______

RECEIVED
JUL -6 1983

PRINCIPAL
TRUST

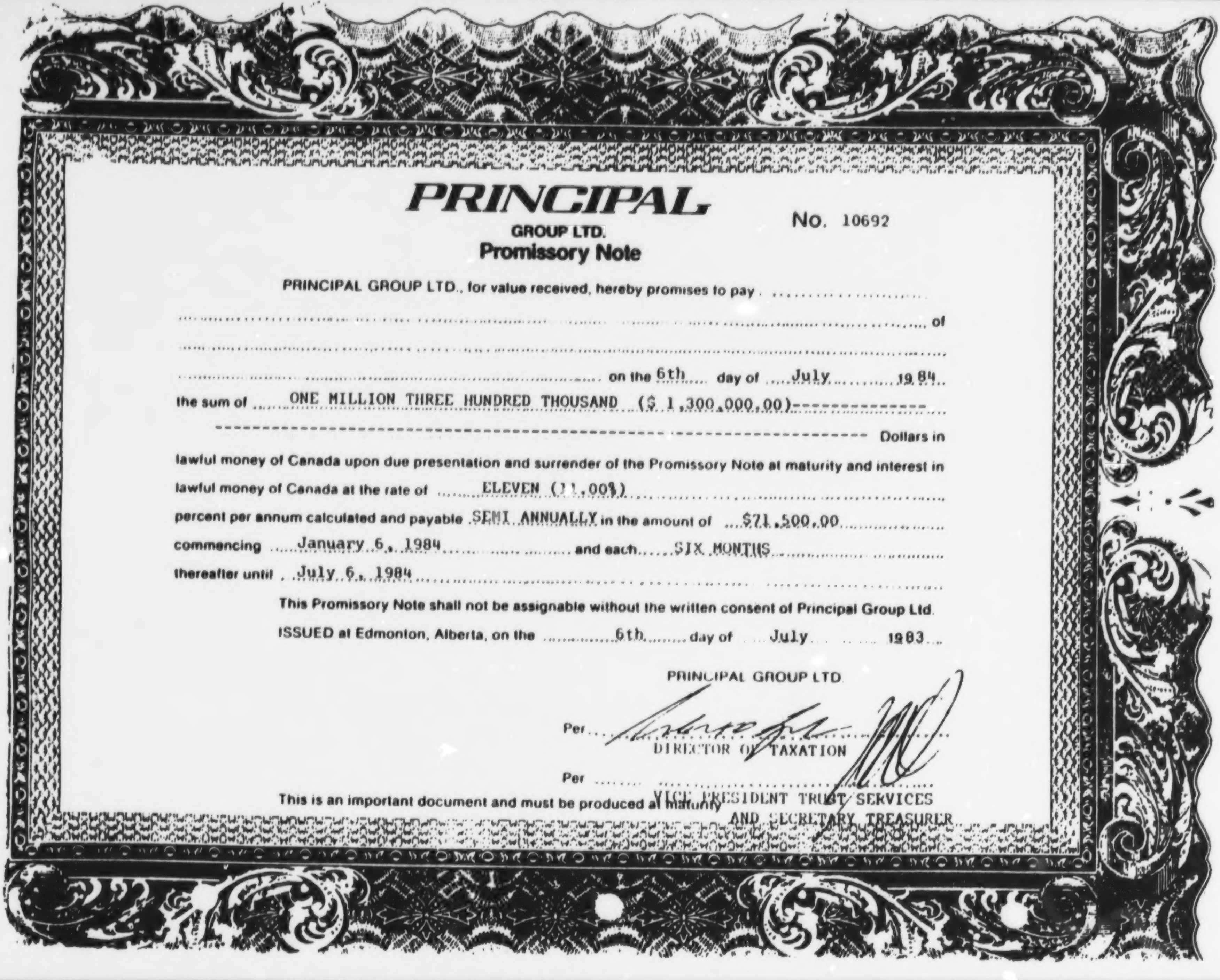
SIGNATURE CARD

PGL 09434

ACCOUNT NUMBER

Name M ______ First Middle Last
Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number
Addr. ______
______ Postal Code
Joint or in Trust For M ______ First Middle Last
Date of Birth ___/___/___ Day Mo. Year ___/___/___ Social Insurance Number
Address ______
______ Postal Code

Type of Account
☒ Chequing ☒ Savings ☐ In Trust For
☐ Joint (Either to sign) ☐ Joint (All must sign)
☐ Other ______
Identification: Type ______ No. ______
Type ______ No. ______
I/We the depositor(s) agree to abide by the regulations stated on the card. (See reverse side.)
Date ___/___/___ Day Mo. Year
Signature(s) ______
______
Consultant ______



PRINCIPAL

GROUP LTD.

Promissory Note

No. 10692

PRINCIPAL GROUP LTD., for value received, hereby promises to pay ....

.... of

....

.... on the 6th day of July 1984

the sum of ONE MILLION THREE HUNDRED THOUSAND ($ 1,300,000.00)--------------

-- Dollars in

lawful money of Canada upon due presentation and surrender of the Promissory Note at maturity and interest in lawful money of Canada at the rate of ELEVEN (11.00%) .... percent per annum calculated and payable SEMI ANNUALLY in the amount of $71,500.00 .... commencing January 6, 1984 .... and each SIX MONTHS .... thereafter until July 6, 1984 ....

This Promissory Note shall not be assignable without the written consent of Principal Group Ltd.

ISSUED at Edmonton, Alberta, on the 6th day of July 1983

PRINCIPAL GROUP LTD.

Per ....
DIRECTOR OF TAXATION

Per ....
VICE PRESIDENT TRUST SERVICES
AND SECRETARY TREASURER

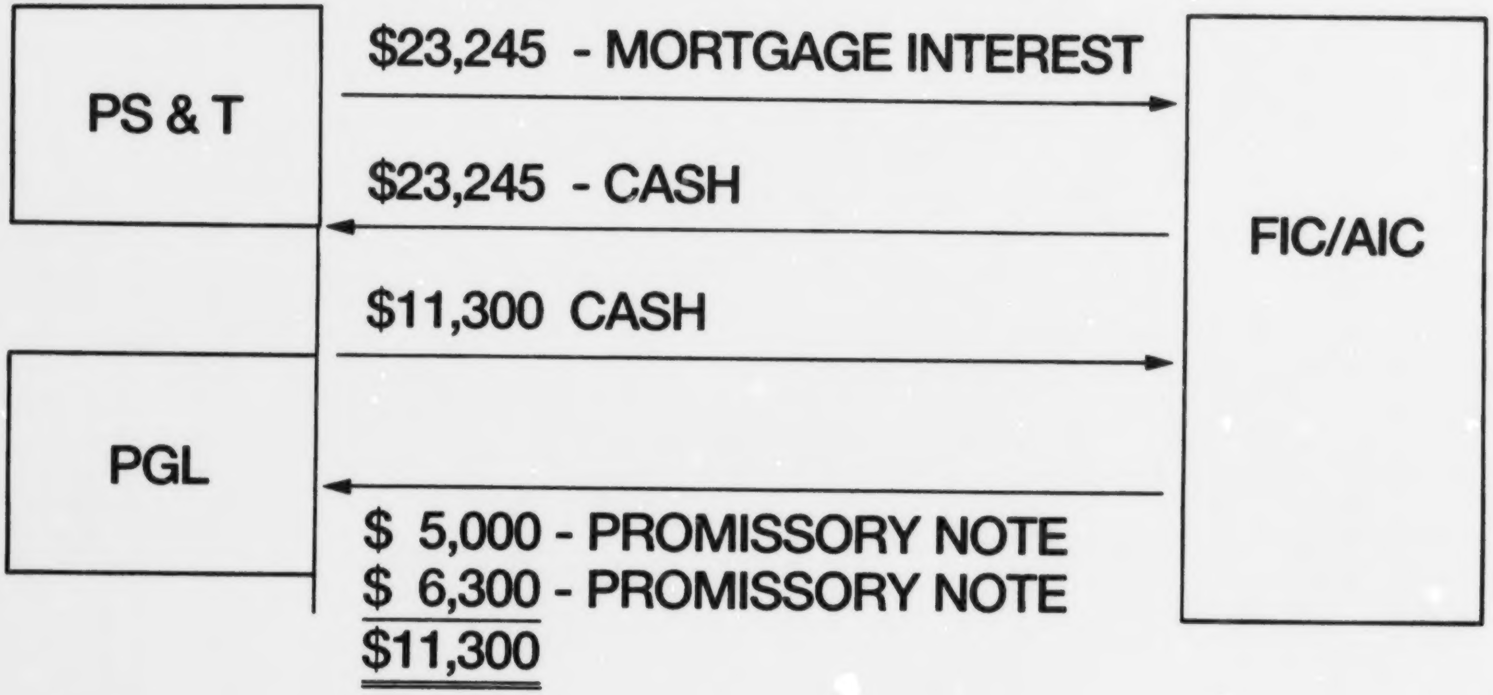
This is an important document and must be produced at maturity

SCHEDULE M

Diagrams of Certain Significant Transactions

Figure 1-2

Transaction No. 1
Sale of Principal Savings and Trust Shared Mortgage Interests to FIC/AIC
March 23, 1984
(000's)



PS & T

PGL

FIC/AIC

$23,245 - MORTGAGE INTEREST

$23,245 - CASH

$11,300 CASH

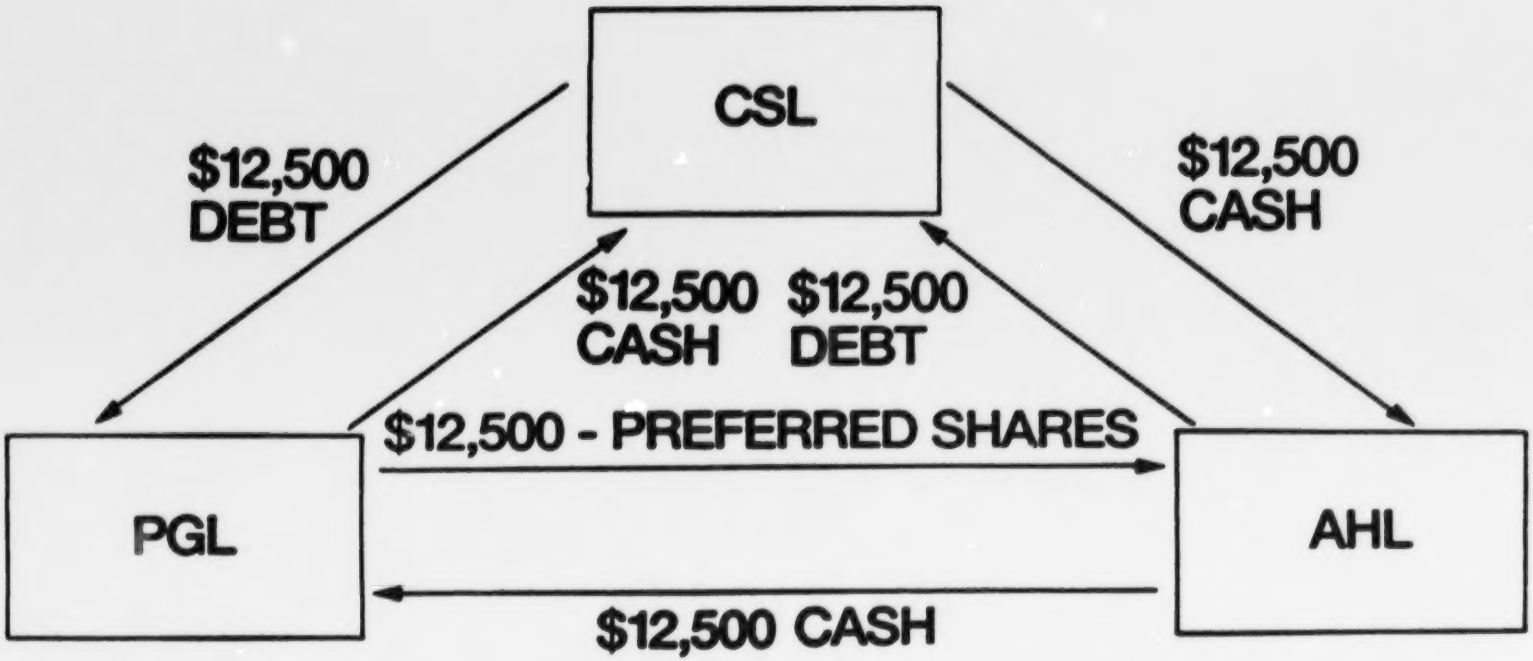
$ 5,000 - PROMISSORY NOTE
$ 6,300 - PROMISSORY NOTE
$11,300

Source: Exhibit 280

Figure 2-2

Transaction No. 2
Athabasca Holdings Limited Purchase of Principal Group Ltd. Preferred Shares
December 1984

(000's)

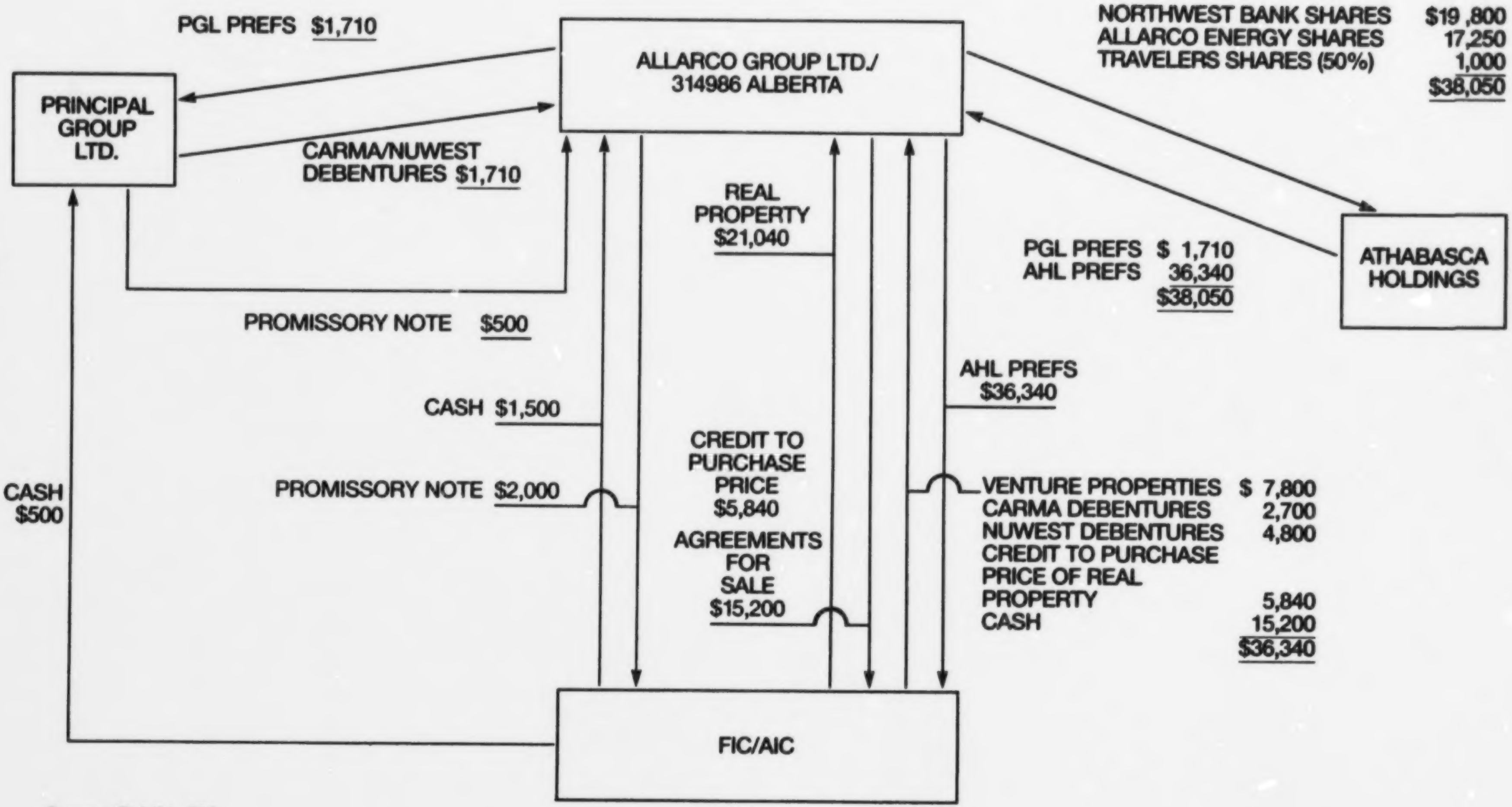

CSL
$12,500 DEBT
$12,500 CASH
$12,500 CASH
$12,500 DEBT
$12,500 - PREFERRED SHARES
PGL
AHL
$12,500 CASH

Source: Exhibit 333

Figure 3-5

Transaction No. 3
Allarco Group Ltd. Transactions
June 29, 1984

(000's)

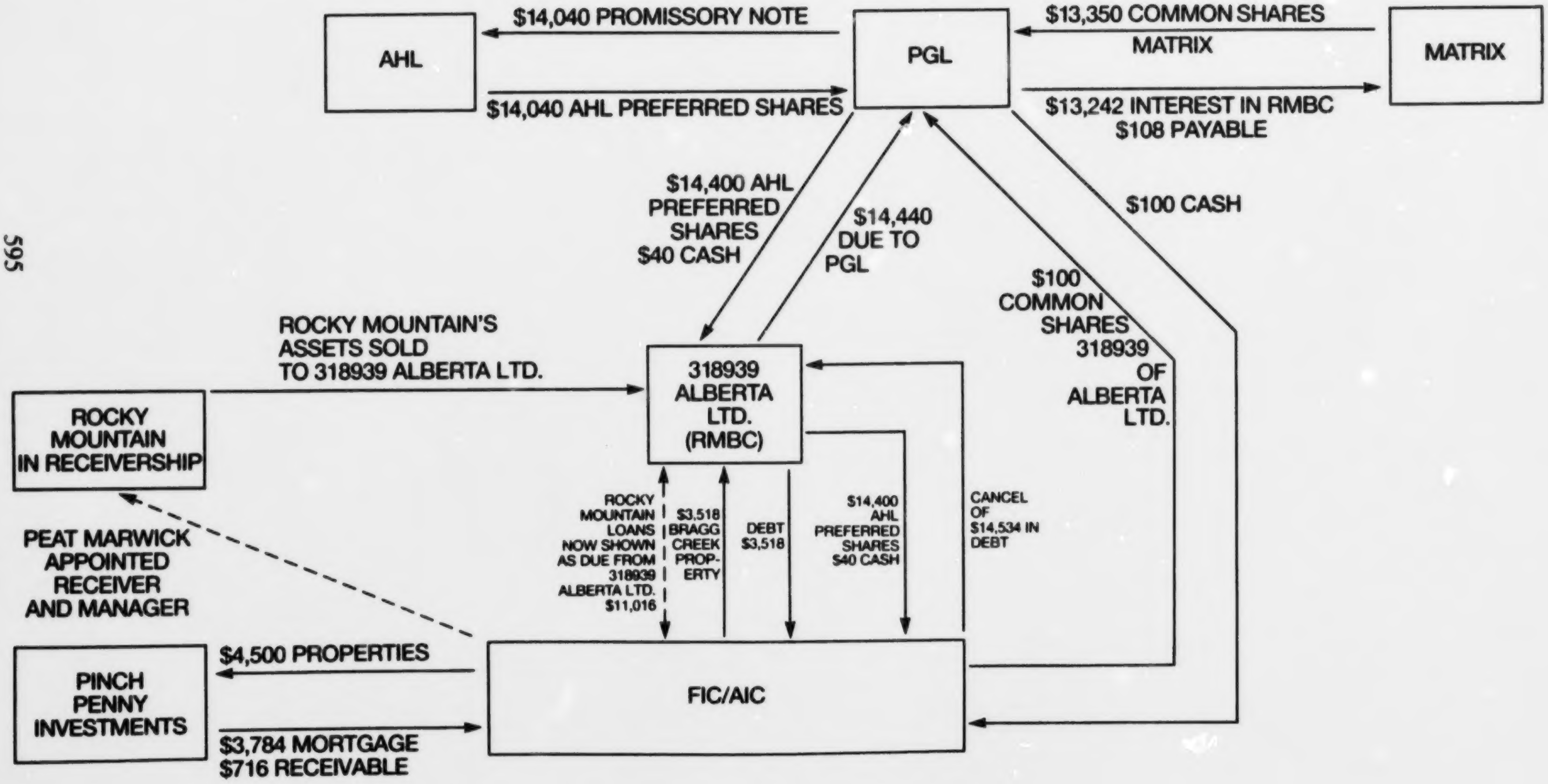


PRINCIPAL GROUP LTD.
ALLARCO GROUP LTD./ 314986 ALBERTA
ATHABASCA HOLDINGS
FIC/AIC
PGL PREFS $1,710
CARMA/NUWEST DEBENTURES $1,710
PROMISSORY NOTE $500
CASH $1,500
PROMISSORY NOTE $2,000
CASH $500
REAL PROPERTY $21,040
CREDIT TO PURCHASE PRICE $5,840
AGREEMENTS FOR SALE $15,200
AHL PREFS $36,340
NORTHWEST BANK SHARES $19 ,800
ALLARCO ENERGY SHARES 17,250
TRAVELERS SHARES (50%) 1,000
$38,050
PGL PREFS $ 1,710
AHL PREFS 36,340
$38,050
VENTURE PROPERTIES $ 7,800
CARMA DEBENTURES 2,700
NUWEST DEBENTURES 4,800
CREDIT TO PURCHASE PRICE OF REAL PROPERTY 5,840
CASH 15,200
$36,340

Source: Exhibit 281

Figure 4-9

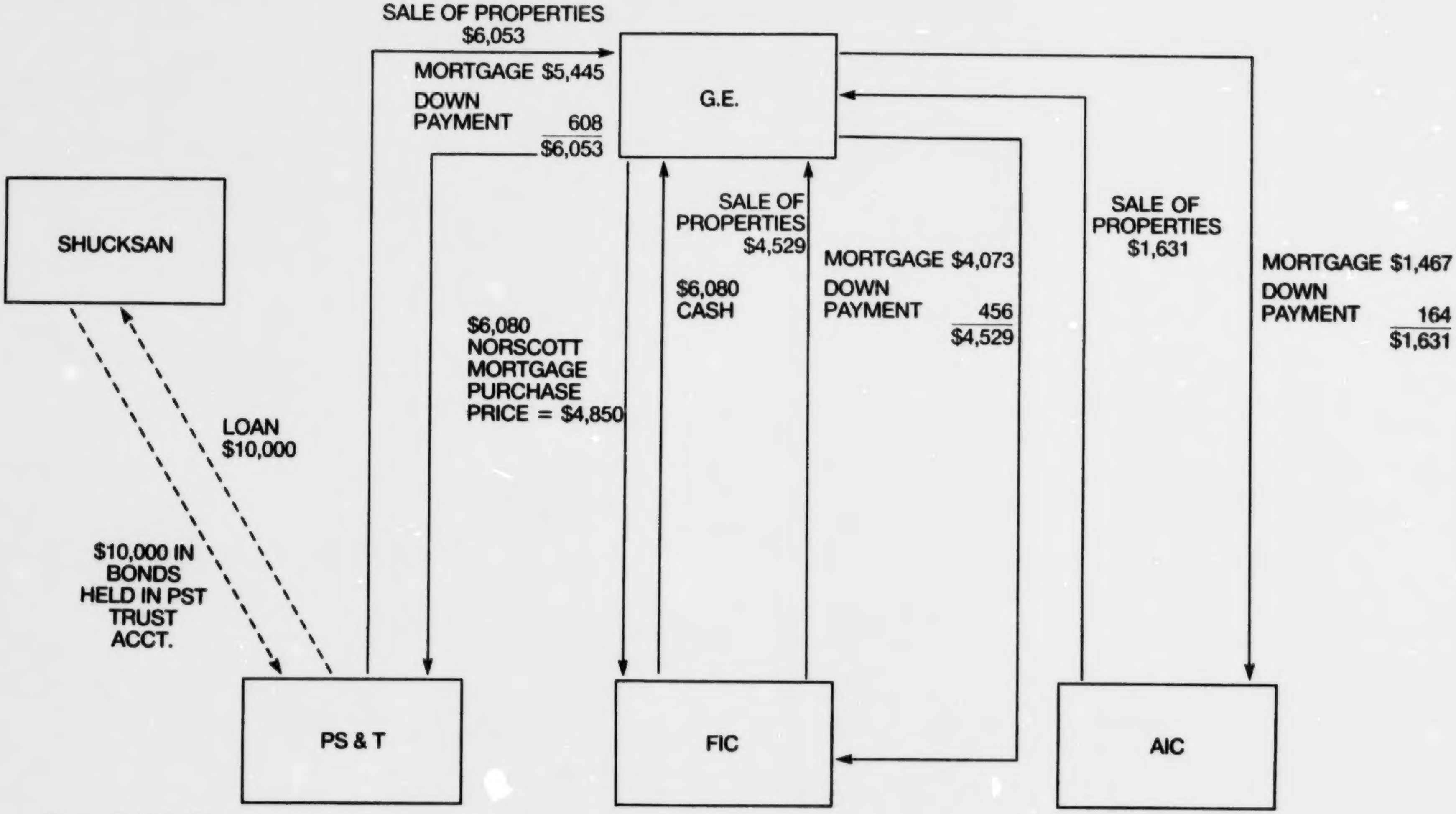
Transaction No. 4
Sale of Rocky Mountain Breweries Ltd.
March, 1985
(000's)


AHL
$14,040 PROMISSORY NOTE
$14,040 AHL PREFERRED SHARES
PGL
$13,350 COMMON SHARES
MATRIX
MATRIX
$13,242 INTEREST IN RMBC
$108 PAYABLE
$14,400 AHL
PREFERRED
SHARES
$40 CASH
$14,440
DUE TO
PGL
$100 CASH
$100
COMMON
SHARES
318939
OF
ALBERTA
LTD.
ROCKY MOUNTAIN'S
ASSETS SOLD
TO 318939 ALBERTA LTD.
318939
ALBERTA
LTD.
(RMBC)
ROCKY
MOUNTAIN
IN RECEIVERSHIP
ROCKY
MOUNTAIN
LOANS
NOW SHOWN
AS DUE FROM
318939
ALBERTA LTD.
$11,016
$3,518
BRAGG
CREEK
PROP-
ERTY
DEBT
$3,518
$14,400
AHL
PREFERRED
SHARES
$40 CASH
CANCEL
OF
$14,534 IN
DEBT
PEAT MARWICK
APPOINTED
RECEIVER
AND MANAGER
$4,500 PROPERTIES
PINCH
PENNY
INVESTMENTS
$3,784 MORTGAGE
$716 RECEIVABLE
FIC/AIC

Source: Exhibit 334

Figure 5-3

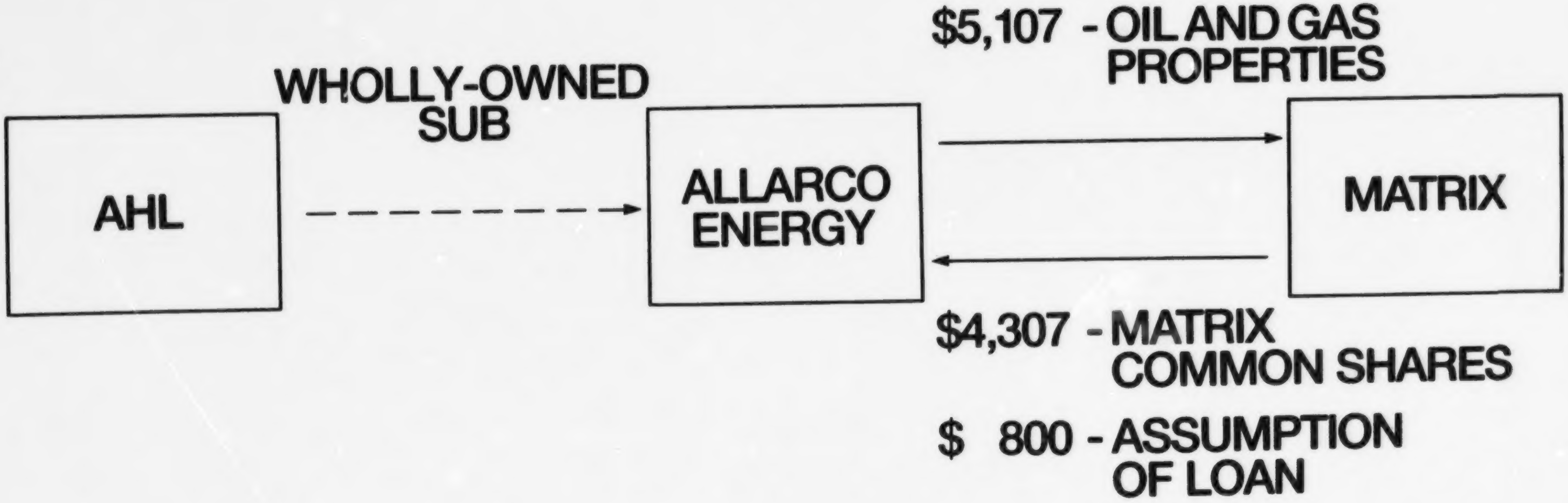
Transaction No. 5
Sale of Mortgages and Properties to General Equities Holdings Ltd.
(000's)


SALE OF PROPERTIES
$6,053
MORTGAGE $5,445
DOWN PAYMENT 608
$6,053
G.E.
SHUCKSAN
SALE OF PROPERTIES
$4,529
MORTGAGE $4,073
DOWN PAYMENT 456
$4,529
SALE OF PROPERTIES
$1,631
MORTGAGE $1,467
DOWN PAYMENT 164
$1,631
$6,080
CASH
$6,080
NORSCOTT
MORTGAGE
PURCHASE
PRICE = $4,850
LOAN
$10,000
$10,000 IN BONDS HELD IN PST TRUST ACCT.
PS & T
FIC
AIC

Source: Exhibit 282

Figure 6-1

Transaction No. 6
Acquisition of Oil and Gas Properties by Matrix Investments Limited
September, 1985
(000's)



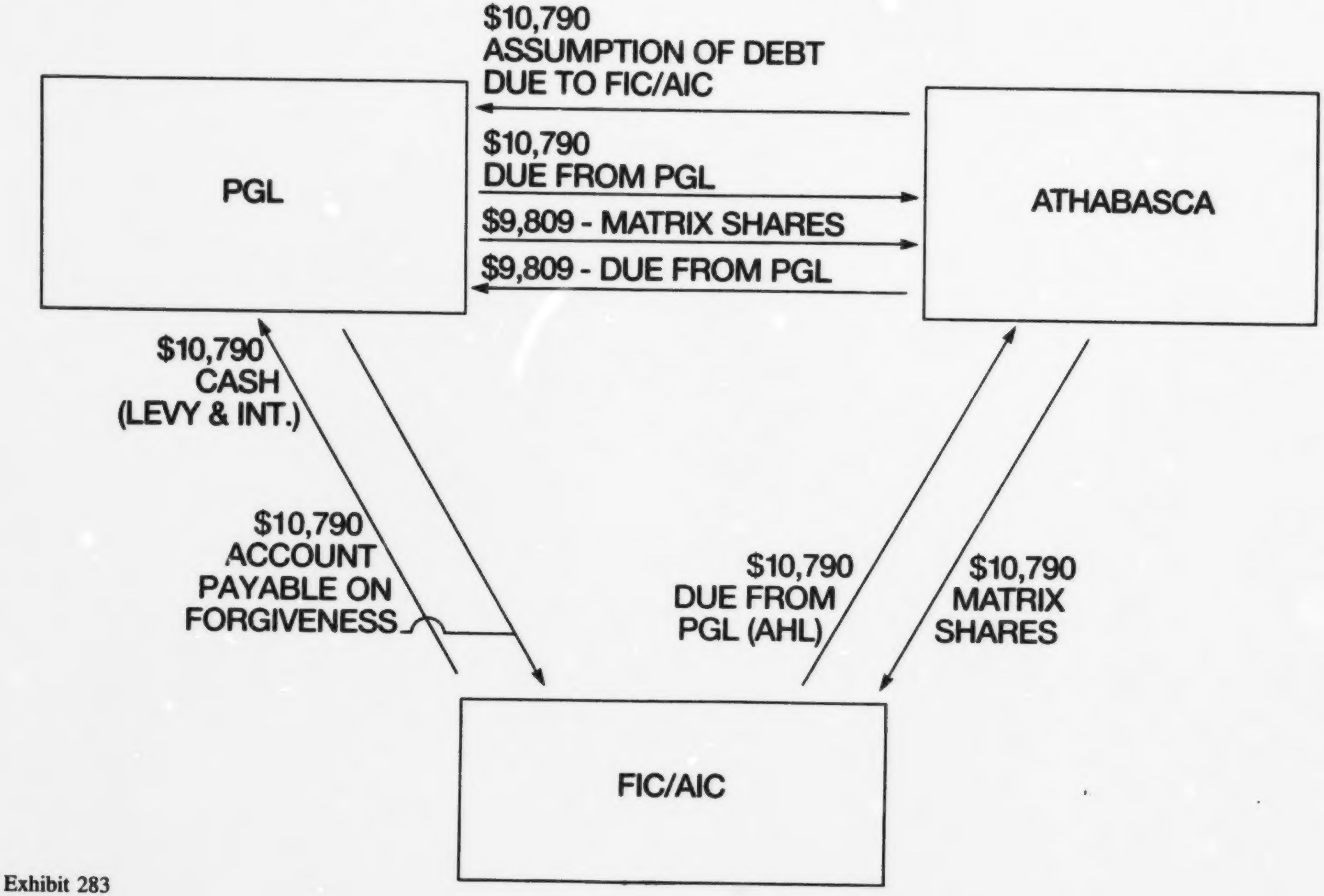
AHL
WHOLLY-OWNED SUB
ALLARCO ENERGY
MATRIX
$5,107 - OIL AND GAS PROPERTIES
$4,307 - MATRIX COMMON SHARES
$ 800 - ASSUMPTION OF LOAN

Source: Exhibit 335

Figure 7-4

Transaction No. 7
Acquisition of Matrix Investments Limited
December, 1985

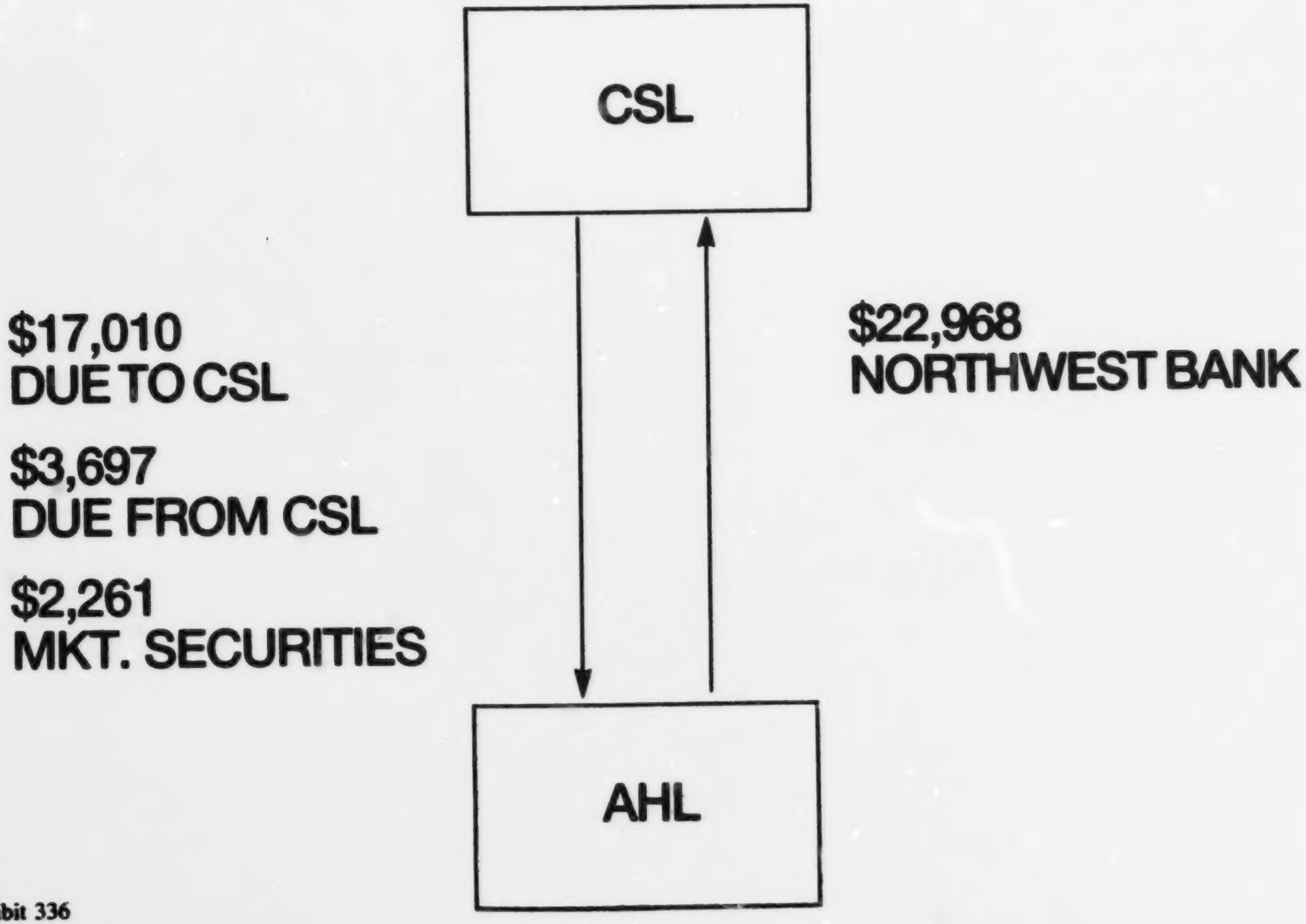
(000's)


$10,790
ASSUMPTION OF DEBT
DUE TO FIC/AIC
$10,790
DUE FROM PGL
$9,809 - MATRIX SHARES
$9,809 - DUE FROM PGL
PGL
ATHABASCA
$10,790
CASH
(LEVY & INT.)
$10,790
ACCOUNT
PAYABLE ON
FORGIVENESS
$10,790
DUE FROM
PGL (AHL)
$10,790
MATRIX
SHARES
FIC/AIC

Source: Exhibit 283

Figure 8-1

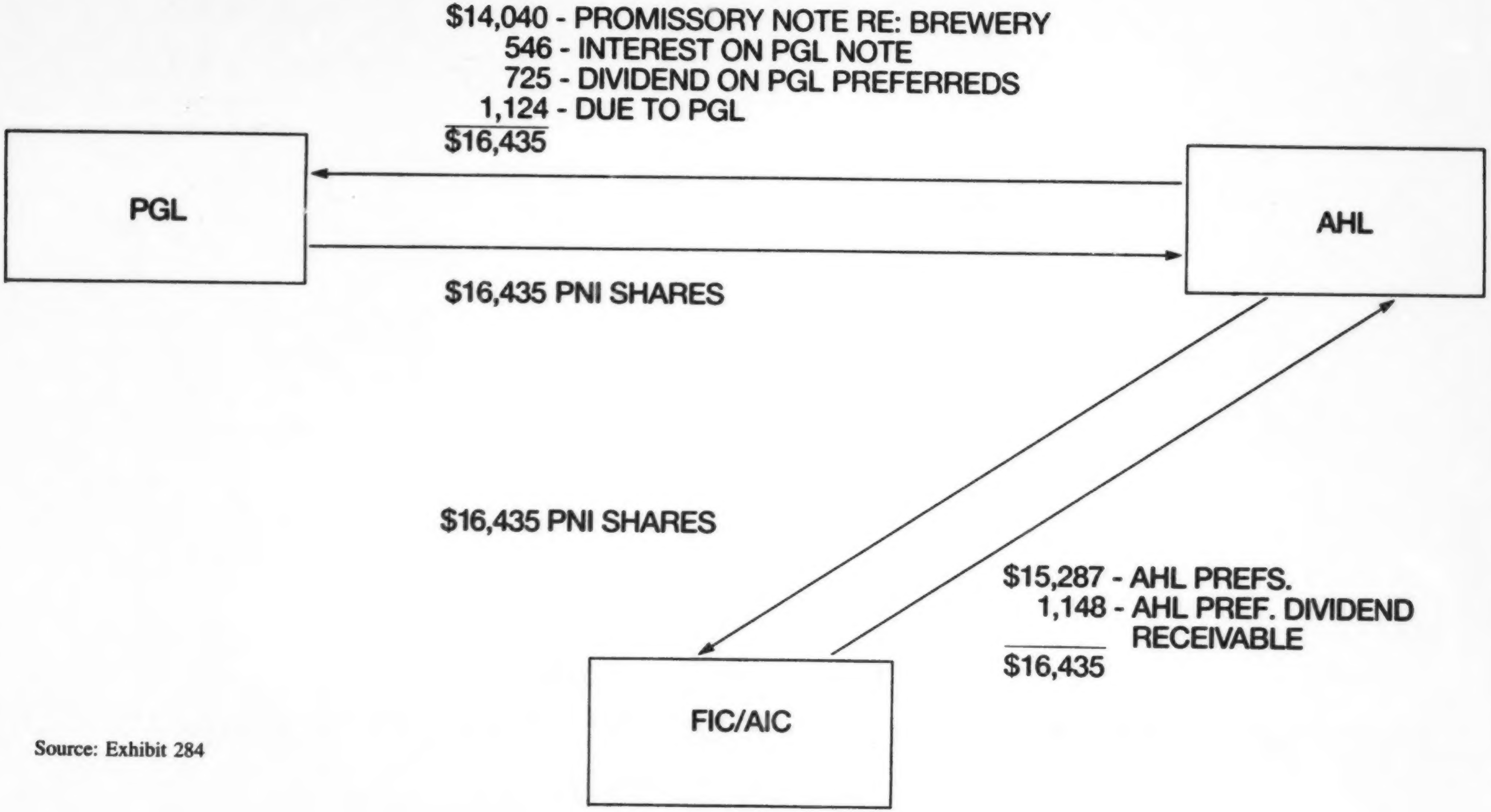
Transaction No. 8
Sale of Northwest International Bank and Trust Company
December, 1985
(000's)


CSL
$17,010
DUE TO CSL
$3,697
DUE FROM CSL
$2,261
MKT. SECURITIES
$22,968
NORTHWEST BANK
AHL

Source: Exhibit 336

Figure 9-2

Transaction No. 9
Acquisition of Principal Neo-Tech Inc.
December, 1985
(000's)



$14,040 - PROMISSORY NOTE RE: BREWERY
546 - INTEREST ON PGL NOTE
725 - DIVIDEND ON PGL PREFERREDS
1,124 - DUE TO PGL
$16,435

$16,435 PNI SHARES

$16,435 PNI SHARES

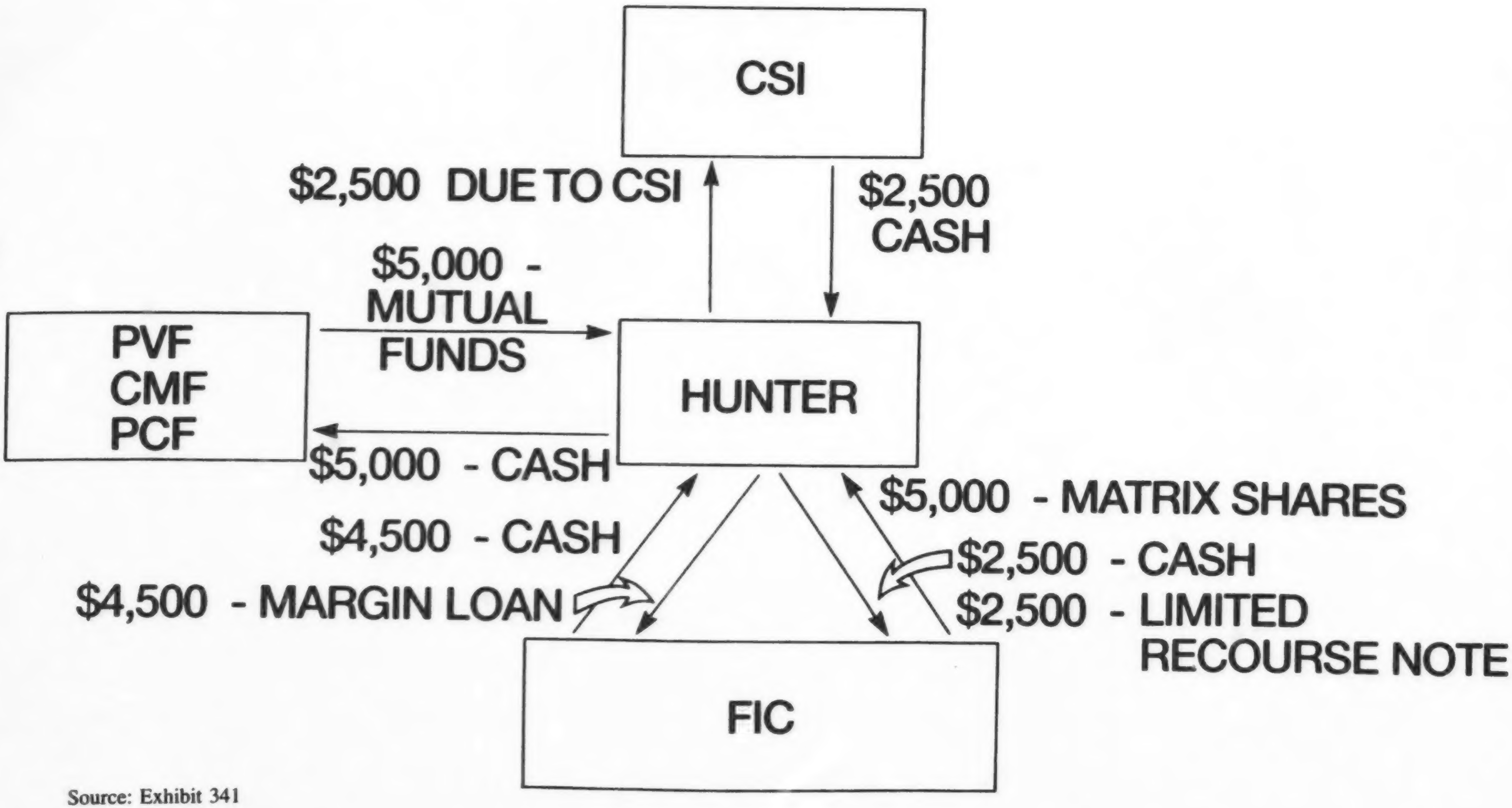
$15,287 - AHL PREFS.
1,148 - AHL PREF. DIVIDEND RECEIVABLE
$16,435

Source: Exhibit 284

Figure 10-3

Transaction No. 10A
East-West Canadian Investment Ltd. and 356539 Alberta Ltd. (Hunter)
November and December, 1986

(000's)

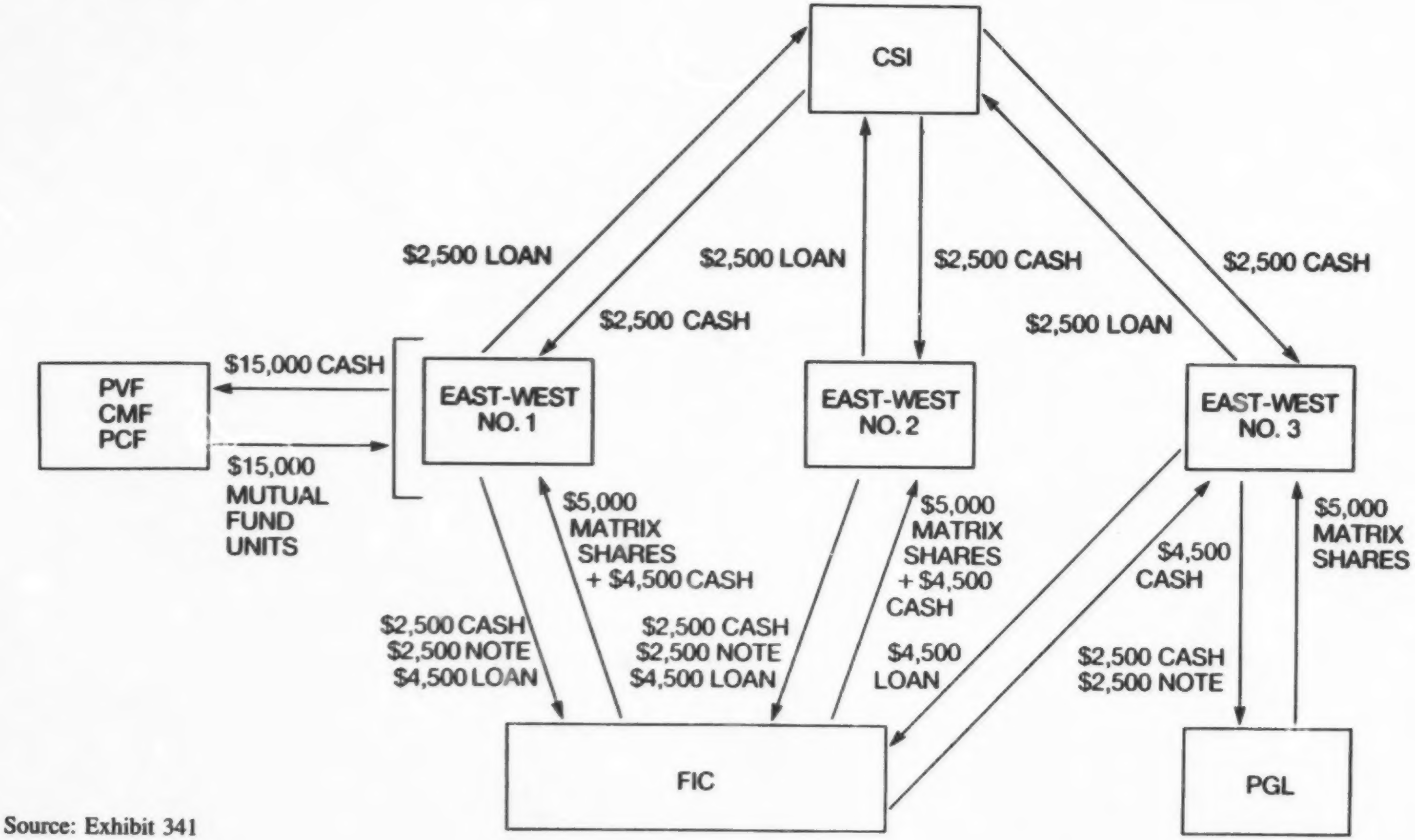

CSI
$2,500 DUE TO CSI
$2,500 CASH
$5,000 - MUTUAL FUNDS
PVF
CMF
PCF
HUNTER
$5,000 - CASH
$4,500 - CASH
$4,500 - MARGIN LOAN
$5,000 - MATRIX SHARES
$2,500 - CASH
$2,500 - LIMITED RECOURSE NOTE
FIC

Source: Exhibit 341

Figure 10-5

Transaction No. 10B
East-West Canadian Investment Ltd. and 356539 Alberta Ltd. (Hunter)
November and December, 1986

(000's)

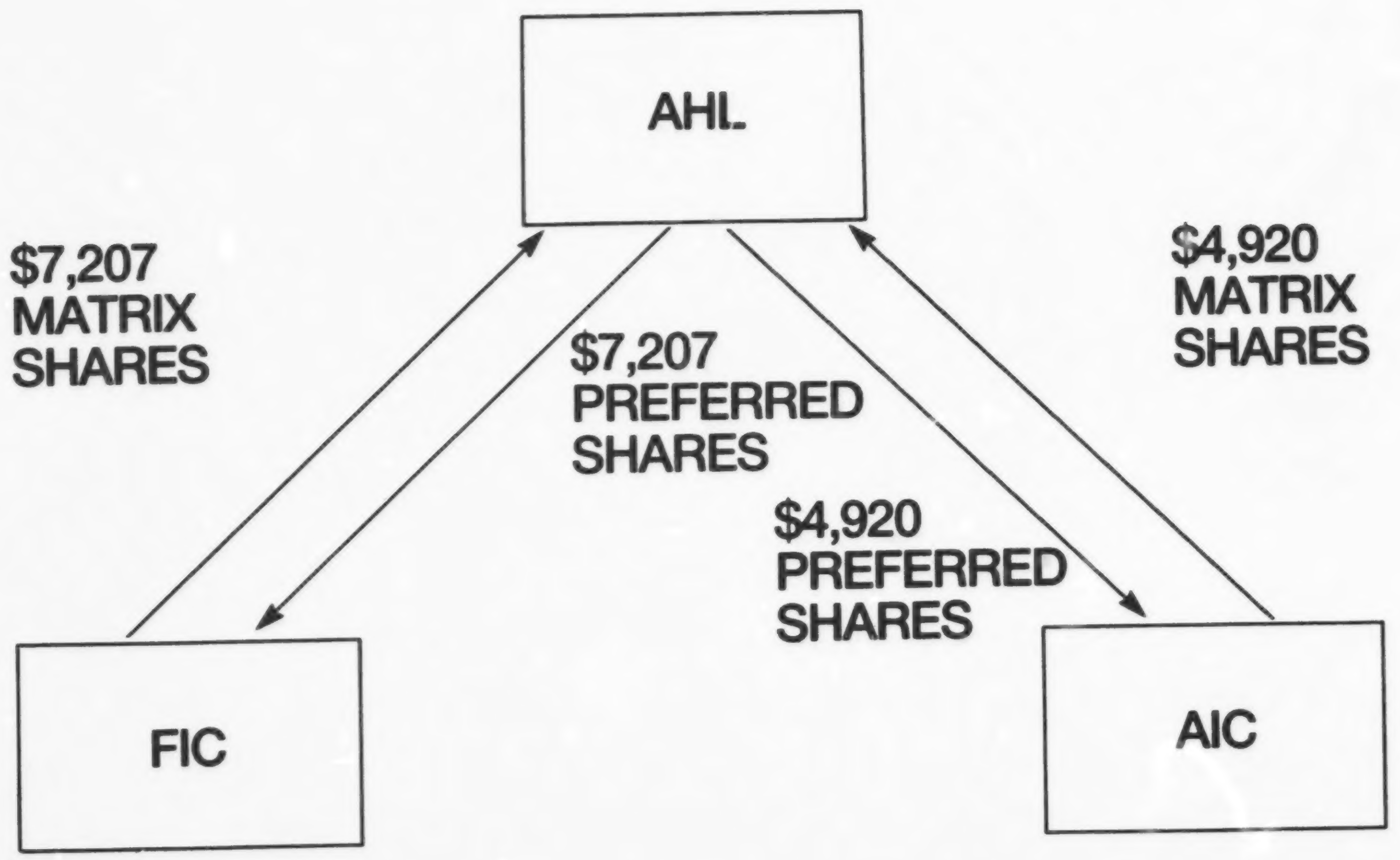

CSI
$2,500 LOAN
$2,500 CASH
$2,500 LOAN
$2,500 CASH
$2,500 CASH
$2,500 LOAN
$15,000 CASH
PVF
CMF
PCF
$15,000
MUTUAL
FUND
UNITS
EAST-WEST
NO. 1
EAST-WEST
NO. 2
EAST-WEST
NO. 3
$5,000
MATRIX
SHARES
+ $4,500 CASH
$2,500 CASH
$2,500 NOTE
$4,500 LOAN
$2,500 CASH
$2,500 NOTE
$4,500 LOAN
$5,000
MATRIX
SHARES
+ $4,500
CASH
$4,500
LOAN
$4,500
CASH
$5,000
MATRIX
SHARES
$2,500 CASH
$2,500 NOTE
FIC
PGL

Source: Exhibit 341

Transaction No. 11
Athabasca Holdings Limited/Matrix Investments Limited Share Exchange
May and December, 1986

(000's)

Figure 11-2

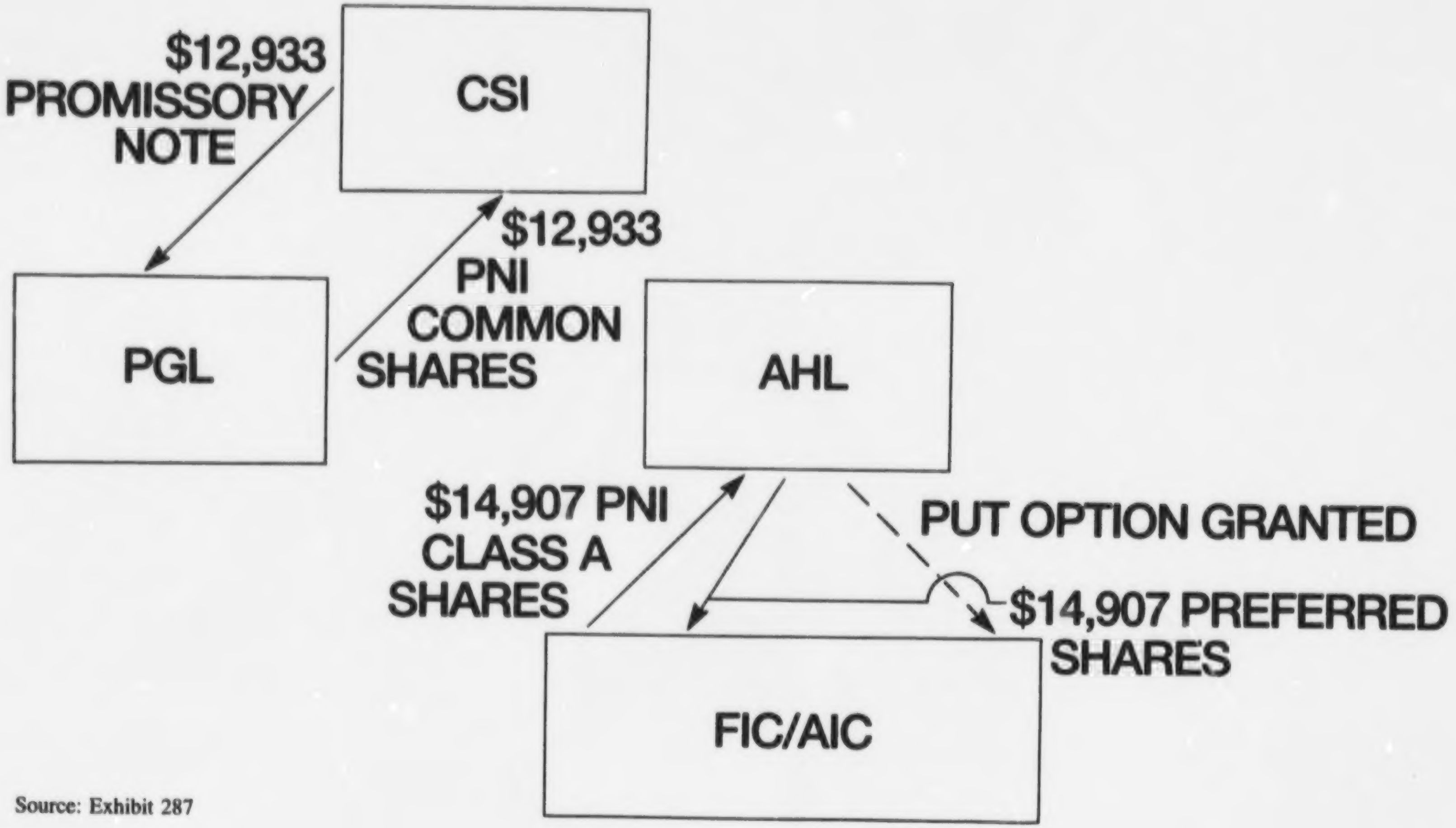

AHL
$7,207
MATRIX
SHARES
$7,207
PREFERRED
SHARES
$4,920
PREFERRED
SHARES
$4,920
MATRIX
SHARES
FIC
AIC

Source: Exhibit 285

Transaction No. 12
Athabasca Holdings Limited/Principal Neo-Tech Inc. Share Exchange
June and December, 1986

(000's)

Figure 12-3

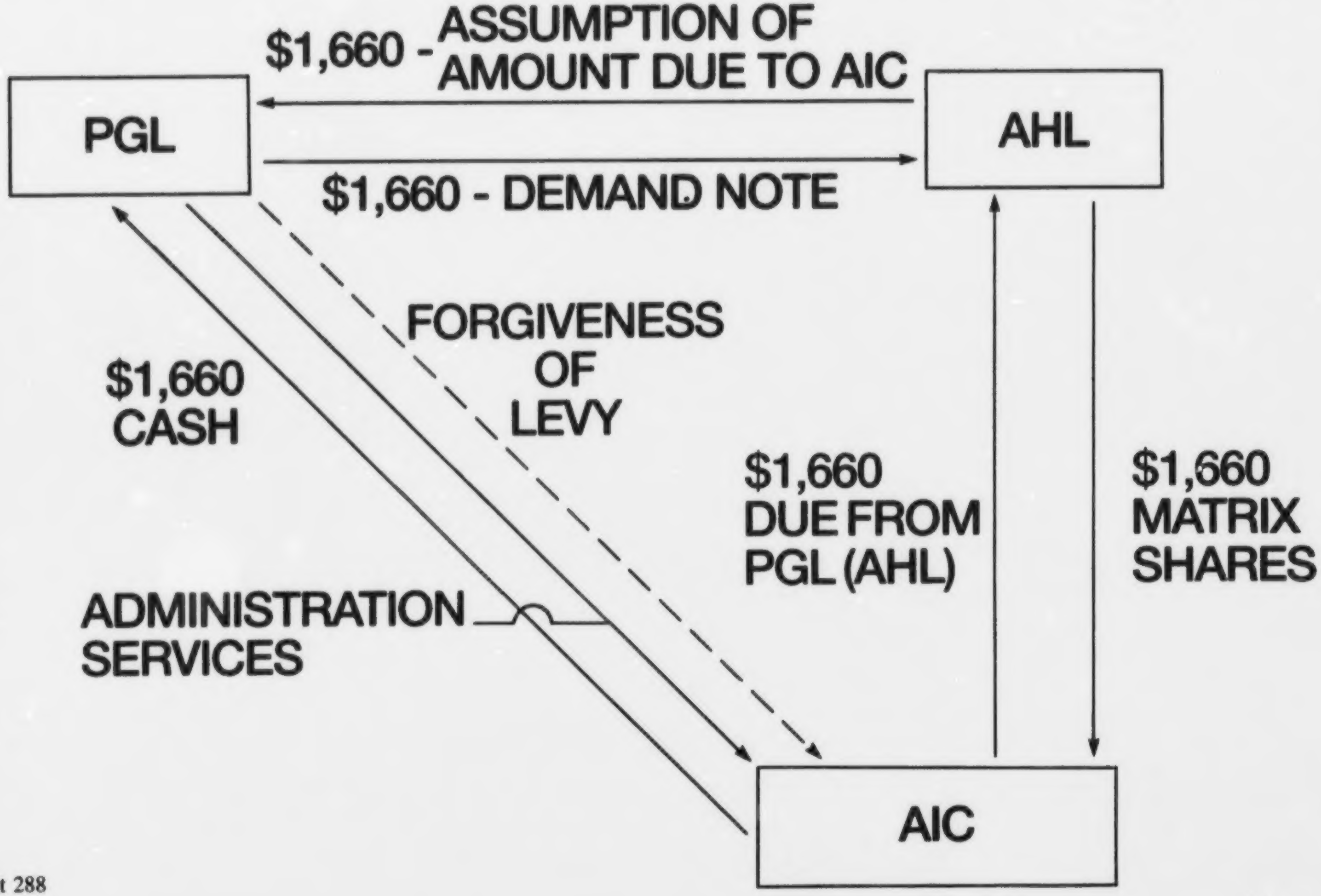

CSI
$12,933 PROMISSORY NOTE
PGL
$12,933 PNI COMMON SHARES
AHL
$14,907 PNI CLASS A SHARES
PUT OPTION GRANTED
$14,907 PREFERRED SHARES
FIC/AIC

Source: Exhibit 287

Transaction No. 13
Principal Group Ltd. Repayment of Administration Levies
December, 1986

(000's)

Figure 13-4

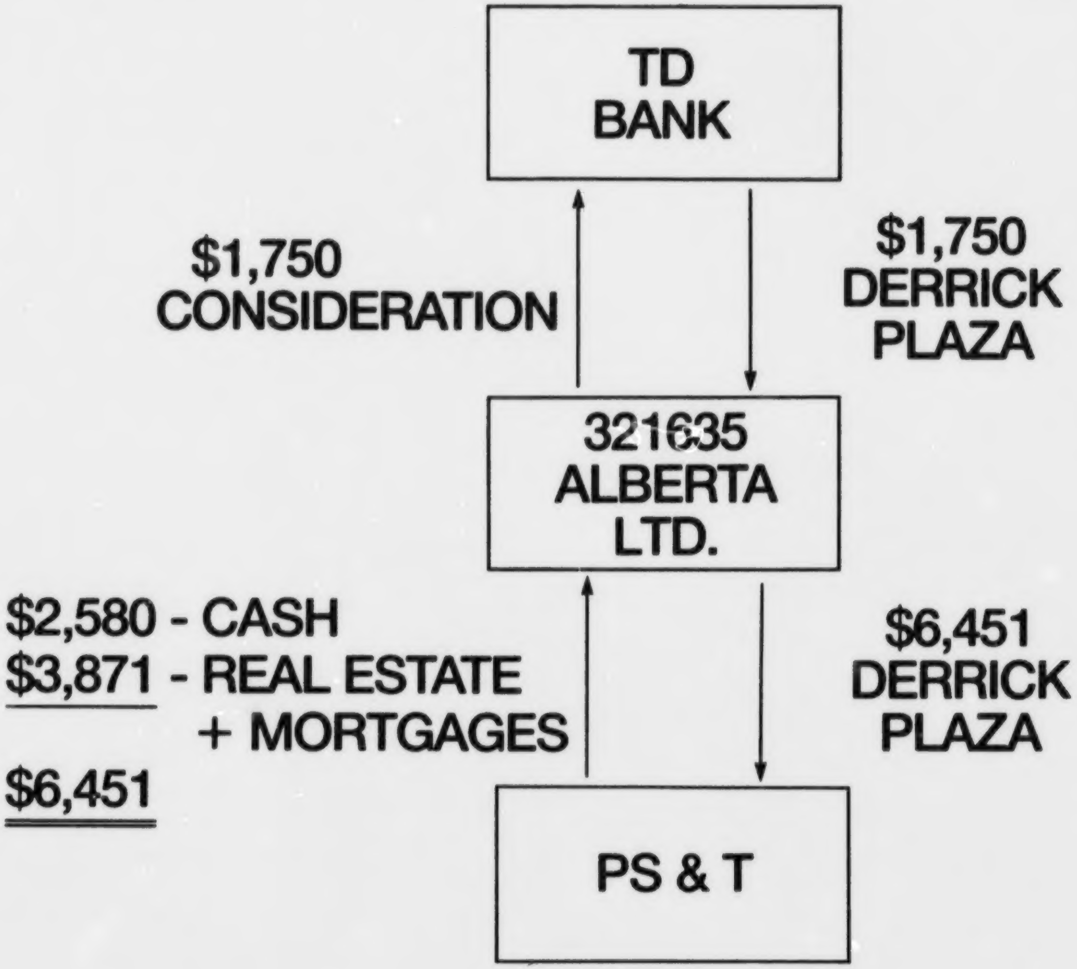

PGL
AHL
AIC
$1,660 - ASSUMPTION OF AMOUNT DUE TO AIC
$1,660 - DEMAND NOTE
FORGIVENESS OF LEVY
$1,660 CASH
ADMINISTRATION SERVICES
$1,660 DUE FROM PGL (AHL)
$1,660 MATRIX SHARES

Source: Exhibit 288

Figure 14-2

Transaction No. 14
Purchase of Derrick Plaza Property
December 19, 1986

(000's)



TD
BANK

$1,750
CONSIDERATION

$1,750
DERRICK
PLAZA

321635
ALBERTA
LTD.

$2,580 - CASH
$3,871 - REAL ESTATE
+ MORTGAGES

$6,451

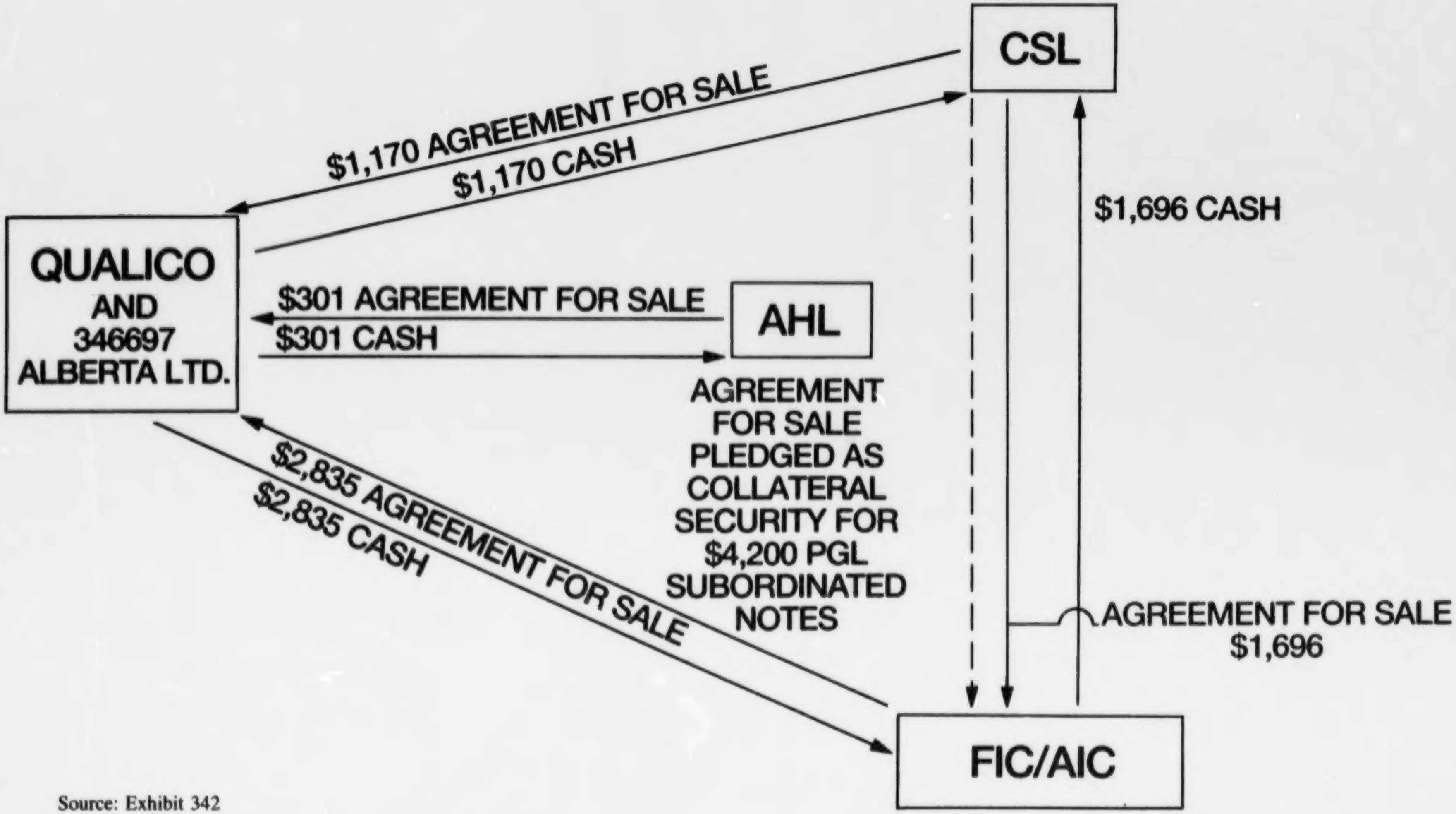
$6,451
DERRICK
PLAZA

PS & T

Source: Exhibit 290

Figure 15-3

Transaction No. 15
Speedway Lands
June, 1986
(000's)

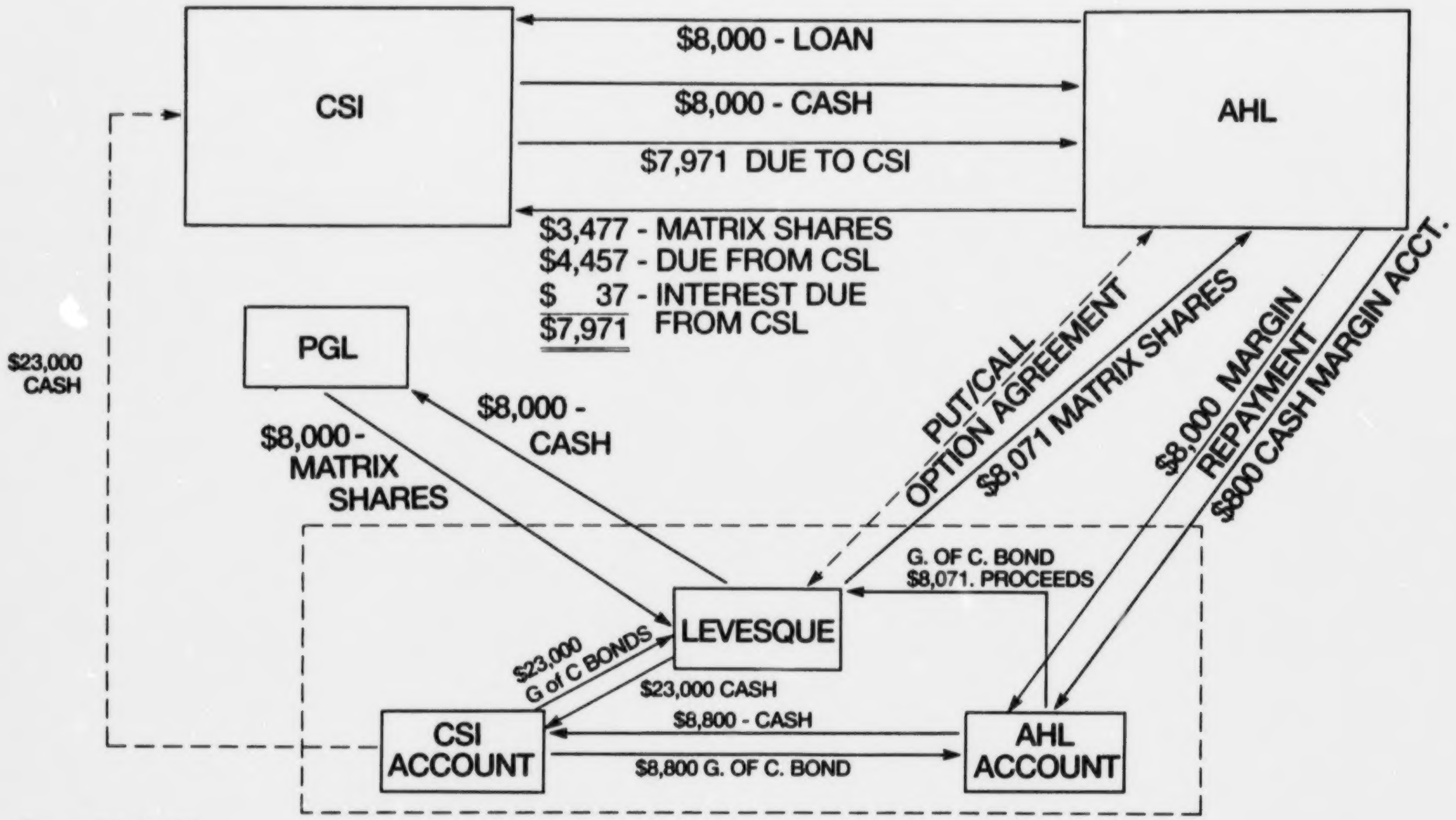

CSL
$1,170 AGREEMENT FOR SALE
$1,170 CASH
$1,696 CASH
QUALICO AND 346697 ALBERTA LTD.
$301 AGREEMENT FOR SALE
$301 CASH
AHL
AGREEMENT FOR SALE PLEDGED AS COLLATERAL SECURITY FOR $4,200 PGL SUBORDINATED NOTES
$2,835 AGREEMENT FOR SALE
$2,835 CASH
AGREEMENT FOR SALE $1,696
FIC/AIC

Source: Exhibit 342

Figure 16-6

Transaction No. 16
Athabasca Holdings Limited – Matrix Shares Put/Call Agreement
December, 1986

(000's)

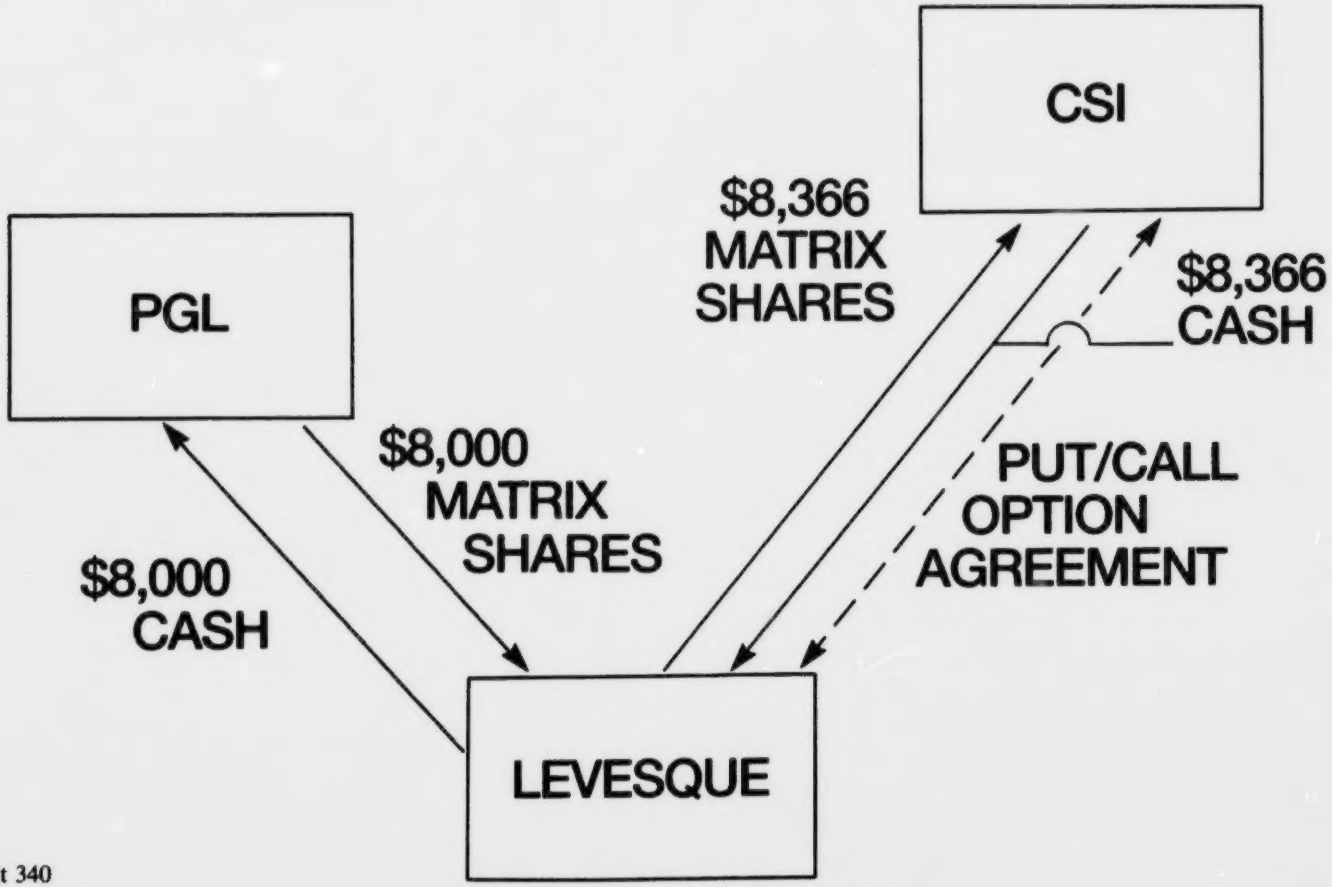

CSI
AHL
$8,000 - LOAN
$8,000 - CASH
$7,971 DUE TO CSI
$3,477 - MATRIX SHARES
$4,457 - DUE FROM CSL
$ 37 - INTEREST DUE FROM CSL
$7,971
PGL
$23,000 CASH
$8,000 - CASH
$8,000 - MATRIX SHARES
PUT/CALL OPTION AGREEMENT
$8,071 MATRIX SHARES
$8,000 MARGIN REPAYMENT
$800 CASH MARGIN ACCT.
G. OF C. BOND $8,071. PROCEEDS
LEVESQUE
$23,000 G of C BONDS
$23,000 CASH
$8,800 - CASH
$8,800 G. OF C. BOND
CSI ACCOUNT
AHL ACCOUNT

Source: Exhibit 339

Figure 17-3

Transaction No. 17
Collective Securities Inc./Matrix Shares
Put/Call Agreement
December 31, 1986

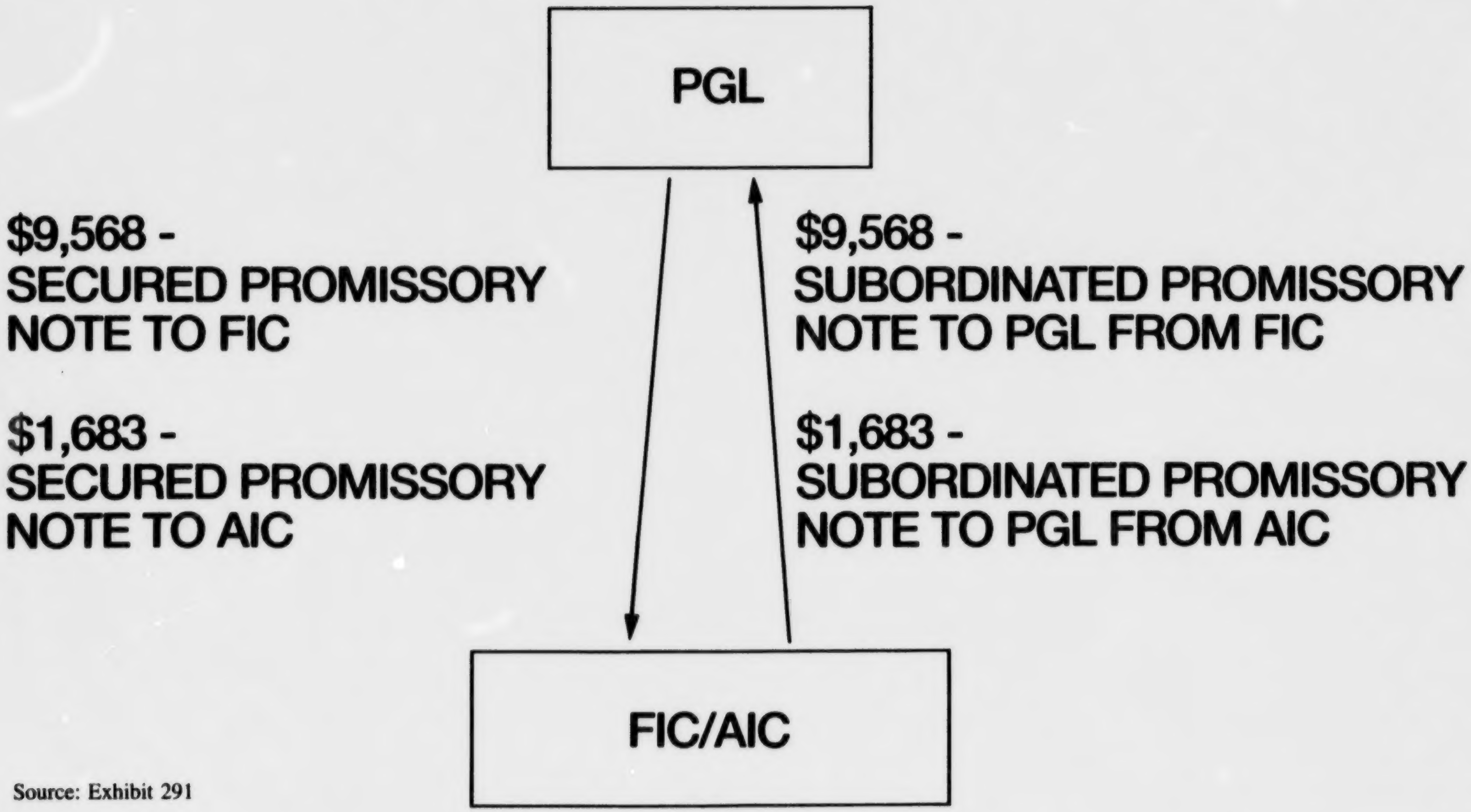
(000's)


CSI
$8,366
MATRIX
SHARES
$8,366
CASH
PGL
$8,000
MATRIX
SHARES
$8,000
CASH
PUT/CALL
OPTION
AGREEMENT
LEVESQUE

Source: Exhibit 340

Transaction No. 18
Principal Group Ltd. Insertion of Qualified Assets
August, 1986
(000's)

Figure 18-1



$9,568 -
SECURED PROMISSORY
NOTE TO FIC

$1,683 -
SECURED PROMISSORY
NOTE TO AIC

$9,568 -
SUBORDINATED PROMISSORY
NOTE TO PGL FROM FIC

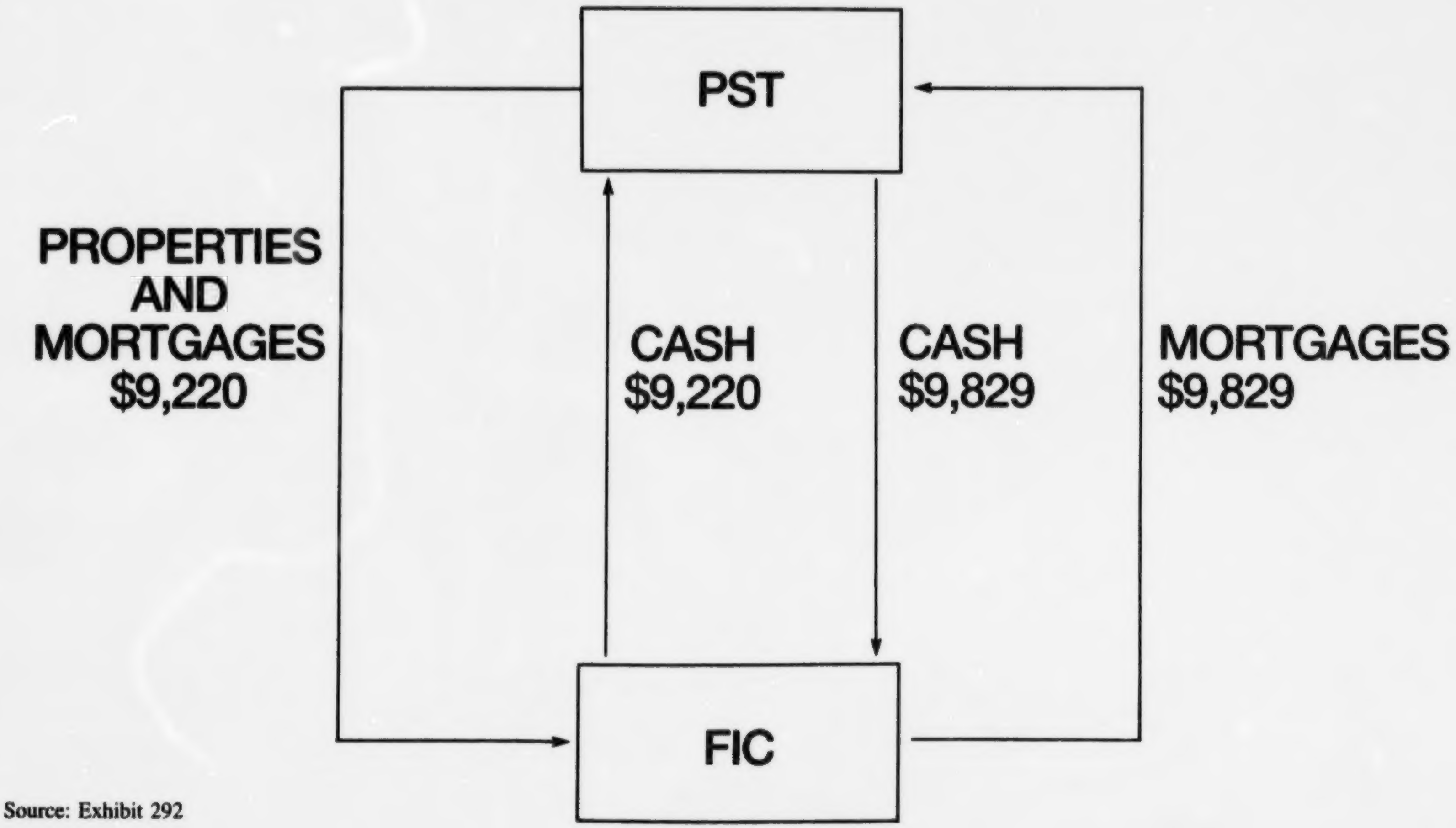
$1,683 -
SUBORDINATED PROMISSORY
NOTE TO PGL FROM AIC

Source: Exhibit 291

Figure 19-2

Transaction No. 19
Sale of Principal Savings and Trust Company's Properties and Mortgages to FIC
December 31, 1986

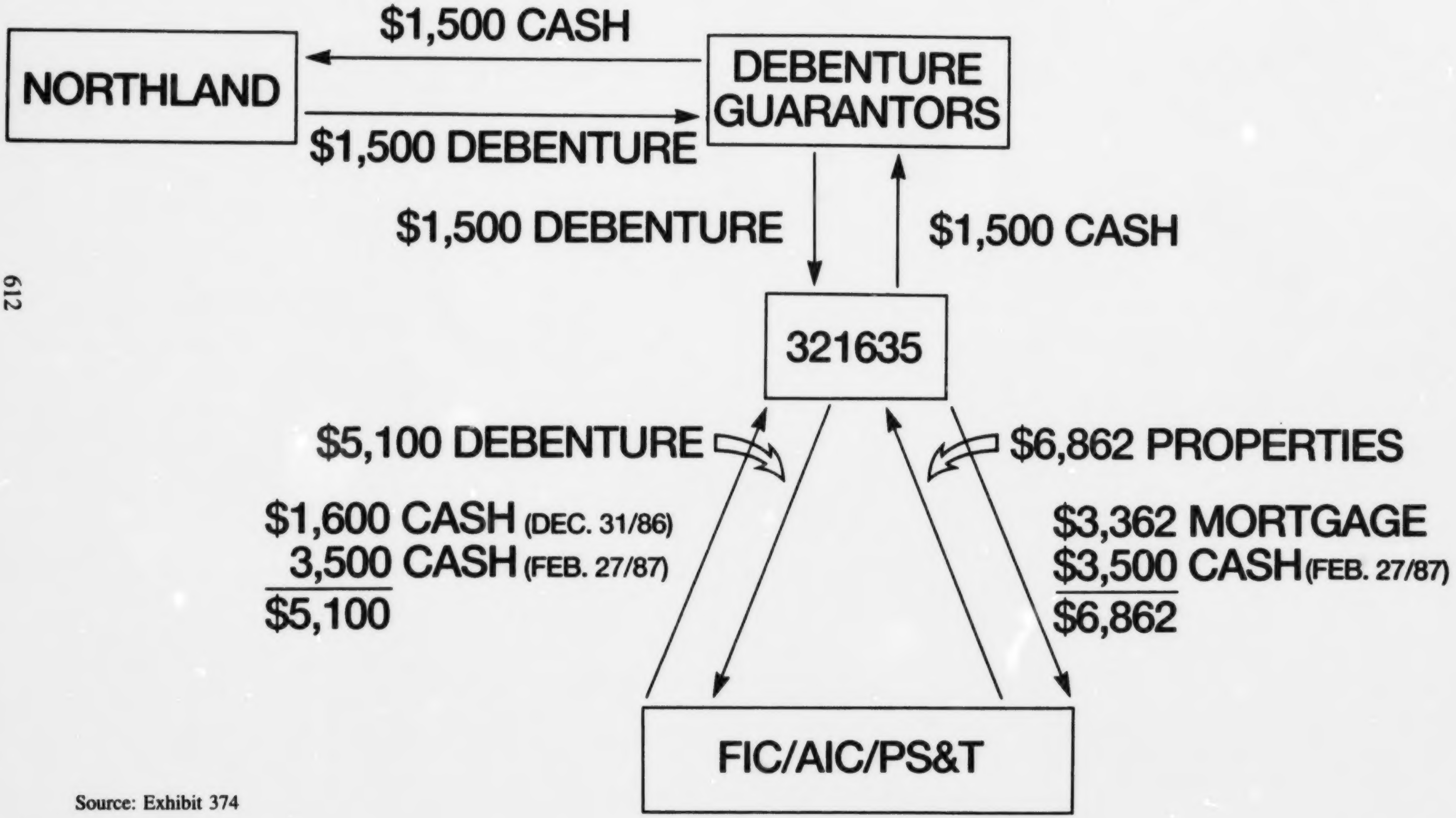
(000's)


PST
FIC
PROPERTIES AND MORTGAGES $9,220
CASH $9,220
CASH $9,829
MORTGAGES $9,829

Source: Exhibit 292

Figure 20-3

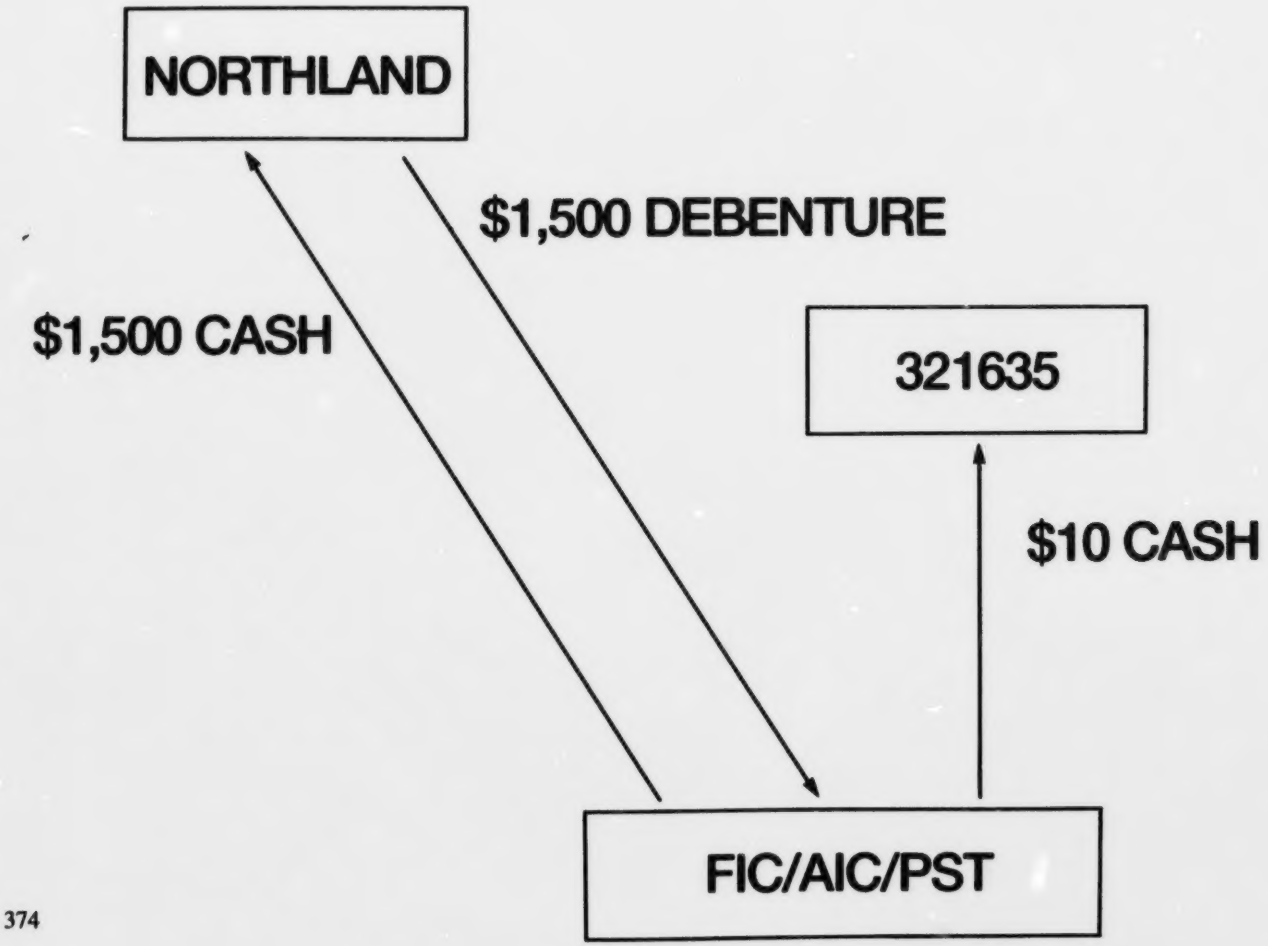
Transaction No. 20
Okanagan Park Resort
December, 1986
(000's)


$1,500 CASH
NORTHLAND
$1,500 DEBENTURE
DEBENTURE GUARANTORS
$1,500 DEBENTURE
$1,500 CASH
321635
$5,100 DEBENTURE
$1,600 CASH (DEC. 31/86)
3,500 CASH (FEB. 27/87)
$5,100
$6,862 PROPERTIES
$3,362 MORTGAGE
$3,500 CASH (FEB. 27/87)
$6,862
FIC/AIC/PS&T

Source: Exhibit 374

Figure 20-4

Transaction No. 20
Okanagan Park Resort
December, 1986
(000's)


NORTHLAND
$1,500 DEBENTURE
$1,500 CASH
321635
$10 CASH
FIC/AIC/PST

Source: Exhibit 374

SCHEDULE N

WITNESSES WHO APPEARED BEFORE THE INVESTIGATION

1. Frank Lukay
2. Amelia Griffin
3. Donald H. Helmers
4. Hubert Ouimet
5. Leonard Clevette
4. Edna Pollard
5. Andrew W. Gillanders
6. Richard Duma
7. Marilyn Duma
8. Robert Osterman
9. Michael Dias
10. Dennis Lewin
11. Vivian Giese
12. Gerald A. Specken
13. Donald L. Eberly
14. Sarla Sharma
15. Ken Pitzel
16. Jean Korte
17. Lavina A. Lychuk
18. Robert V. D'Eath
19. Henry M. Todd
20. Gloria A. Renouf
21. Sylvia J. Bowes
22. Rose Marie Cook
23. Barry Armstrong
24. Garry W. Bassani
25. Gerald F. Heffernan
26. Parminder Dhillon
27. Thomas Richardson
28. John Rodden
29. Kathryn A. Burtch
30. Paul Marchuk
31. Duncan Downie
32. Irene Downie
33. Edward H. Romaine
34. Patricia W. Peet
35. Bonnie L. Lucy
36. Abu R. Nurmohamed
37. Helen B. Ross
38. Marjorie G. Given
39. Volker H. Uhlich
40. Robert M. Gies
41. Norris Gale Koch
42. Ruth V. Hogue
43. Moina N. Sayeed
44. Iris Semeniuk
45. Wilfred J. McDonald
46. Marilyn D. Klingspon
47. Bonita Bray
48. Ruth Edlund
49. Lloyd Robbins
50. Arthur Charbonneau
51. Norma Cleland
52. Velma Schwartz
53. Morgan Hinchey
54. Donald Fitzgerald
55. Tormod Wessel
56. Grace Webster
57. Sheila Ball
58. Stephen Kostyal
59. Viola Pearson
60. Anita Maurier
61. Robert J. Wheaton
62. Hector Hallatt

WITNESSES - *(continued)*

63. Lawrence E. Gallucci
64. Marlow Lissell
65. Ronald Wilderman
66. Fred John Wakulich
67. Richard Carl Chalmers
68. Robert Becker
69. Margaret Ann Mailman
70. Diane Kriss
71. William Hemphill
72. Ellen Blair
73. John Monteith
74. Jacob Kleinsasser
75. George Walter
76. Jacob Wurz
77. Gordon Randall
78. Donald A. Slater
79. John Brian Pullishy
80. Joseph Pejnovic
81. Barry Hart
82. Tim Carruthers
83. Arney Falconer
84. Walter William Green
85. Robert Chan
86. Roberta Keleher
87. Duncan Scott Schroder
88. Douglas Haydock
89. George Emil Aboussafy
90. Louis Gratton
91. Chris Wallace
92. Wally Noble
93. Hugh James Moulton
94. John F.S. Ritchie
95. Richard Mathes
96. Clarence William (Bill) Green
97. Lance Frazier
98. Grant Mitchell
99. S. William Johnson
100. Robert W. Pearce
101. Diane Stefanski
102. Lynn Patrick
103. Barbara Jones
104. John Mills Cormie
105. Christa Petracca
106. James I. Hunt
107. Kenneth Nelson Marlin
108. James Cormie
109. Donald M. Cormie, Q.C.
110. Eric Espenberg
111. Judith Halvorson
112. Wayne Fuhr
113. John Ryan*
114. Jack N. Agrios, Q.C.
115. Virginia Nicholson
116. Douglas Bruce Pennock
117. Donald Lorne McCutchen
118. Anthonie V. Wooldridge
119. James Darwish
120. Nicholas A. Romalo
121. Allan George Hutchison
122. Burton Eldridge
123. Douglas George Higgins
124. Syed Zaf Bokhari
125. Bernard Anthony Rodrigues
126. Reg Pointe

WITNESSES - *(continued)*

127. Tewfik Saleh
128. J. Barry Martin
129. Constantine Osterman
130. Alfred Kalke
131. Allister McPherson
132. James Allan Adair
133. Archibald Johnston
134. George H. Kinsman
135. Lou Hyndman
136. James Angus Reid Watt
137. John Kolosky
138. Richard Cormier
139. Steve Low
140. Ernest Frederick Smith
141. Earl Thomas Jewitt
142. David Robertson Sinclair
143. Gordon Ronald Barefoot
144. Donald R. Getty**
144. Peter Frederick Schenkelberg
145. J. Stephens Allan
146. Muriel Meier
147. Maude Warner
148. Edward J. Shaske
149. Michael Ross
150. Robert Leonard Mansell
151. Claire Marie Ehman-Jolicoeur
152. Bryan Pinney
153. Gary Davidge
154. Rory Kidd
155. Thomas P. Callaghan

* Evidence given *viva voce* and by Statutory Declaration
** Evidence given by Statutory Declaration

SCHEDULE O

COUNSEL APPEARING AT THE INVESTIGATION

Province of Alberta	J.C. Major, Q.C. W.S. McKall B. Hewitt C. Enns T. Feehan
Donald Cormie, James Cormie and John Cormie	R.L. Duke W.J. Kenny J.W. Yurkovitch B.D. Heck L.C. Hoyano M.J. Bailey
Collins Barrow Ltd. of Principal Group Limited, Trustee in Bankruptcy	B.A.R. Smith, Q.C. C.L. Kenny B. Lester P. Stanton
Ken Marlin	K.J. Chapman W.A. Kachman
Investors' Counsel	R.B. White, Q.C. E.A. Johnson R.J. Shaw K.H. Davidson J.E. Topolniski
	J.G. McNiven J.G. Greenan K.J. Martens C.I. MacLean C.K. Thietke
B.I. Robertson and Associates Trustee in Bankruptcy of Principal Savings & Trust Company Limited	K. Bailey, Q.C. T.A. Cockrall U.M. Tauscher P.C. Gwynn N.B. Thompson J.O. Billingsley R. Smith
Coopers & Lybrand Limited, Receiver Manager of First Investors Ltd. and Associated Investors of Canada Ltd.	W.E. Wilson, Q.C. D.N. Tkachuk B.D. Young
	D.N. Jardine D.J. Lobay
H.J. Moulton, Robert Pearce, S. William Johnson, Lynn Patrick, John Ritchie	J.P. Warner, Q.C. J.B. Champion B.J. Kickham

Deloitte Haskins & Sells	R.A. McLennan, Q.C. R.G. McLennan
Christa Petracca	S.L. Harper, Q.C. B.R. Liddell S.A. Sorenson
Jim Darwish	F. Slatter
Touche Ross & Co. and Bruce Pennock	R.J. Wilkins, Q.C.
Tewfik Saleh	S.A. Bercov, Q.C. B.F. Hughson
Judith Halvorson	E.H. Molstad, Q.C. J.A. Wachowich D.M. Russell
Claire Joliceur-Ehman	C. Lee
Merrill Lynch	C.D. O'Brien, Q.C.
Levesque Beaubien and Angus Watt	R.L. Leclerc R.J. Turner B. Zalmanovitz
Doug Haydock	G.C. Field, Q.C.
Louis Gratton	G.A. Riskin
Lance Frazier	L.M. Dolgoy
Grant Mitchell	G.H. Akers G.F. McKibben
Eric Espenberg	D.F. Reay K.W. Fedorak
British Columbia Regulators	D.C. Prowse

SCHEDULE P

INVESTIGATION LEGAL STAFF

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M. L. Sigurdson
D. W. Poulton
R. M. Carter Prévost

CLARKSON GORDON AND WOODS GORDON

P. K. Lane
R. Doroniuk
G. H. Barefoot
R. J. Cormier

INVESTIGATION CLERK

William Lewis

INVESTIGATION OFFICE STAFF

Michelle Bozzer
Shannon Boyd
Marie Dubord
Betty Keith
Brenda Olsen
Irene Stoltz

J. G. MOORE & ASSOCIATES LTD.

J. Garry Moore
Susan Stetter
Anne Baker
Deborah Mullen
Dolores Williams
Carolyn Shelton
Penny Vincent
John Bennett
Marion Moore

VAN MECHELEN SOUND SERVICES

Fred Van Mechelen
Bert Van Mechelen
Nancy Van Mechelen